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hydro One

Connecting at the speed of life

our first annual report 1999

We will power change. We will

Competitive Advantages

- Primarily manages regulated "wires business"
- Established leadership position in a flourishing Ontario economy
- Represents about 93% of Ontario's transmission and 33% of Ontario's distribution market share
- High barriers to entry
- Strong, business-oriented Board and experienced senior management

Strong Financial Position

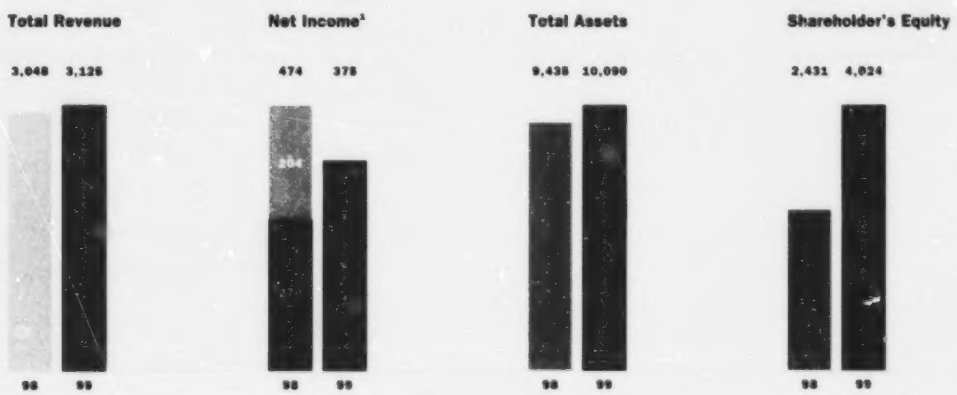
- Strong "A" credit rating
- Solid interest rate coverage, top tier of Canadian utilities
- Strong balance sheet
- Minimal exposure to electricity price fluctuation
- Conservative capital structure (55% debt, 45% equity)
- Stable and predictable cash flows

Strategies for Growth

- Grow and optimize existing products and services
- Select low risk growth opportunities
- Optimize profit and shareholder value
- Integrate transmission and distribution businesses
- Achieve operational excellence, lower overall costs and streamline operations
- Improve labour productivity with incentive-based compensation

financial highlights

(Canadian dollars in millions except interest coverage and debt ratio)



Year ended December 31	1999	1998
Revenues	**3,125**	3,048
Financing Charges	**381**	559
Net Income[1]	**375**	474
Without the Revaluation of the Deferred Pension Asset	**375**	270
Cash Provided by Operations	**794**	520
Total Assets	**10,090**	9,435
Long-Term Debt[2]	**3,446**	5,128
Interest Coverage[3]	**2.26**	1.82
Debt Ratio[4]	**0.546**	0.718
Shareholder's Equity	**4,024**	2,431
Capital Expenditures	**529**	394

[1] Net income for 1998 includes a one-time adjustment for the revaluation of the deferred pension asset of $204 million.

[2] This item excludes the current portion of long-term debt.

[3] Interest coverage is calculated as income before interest expense and provision for payments in lieu of corporate income taxes divided by total interest cost. In 1999, the gain on the sale of the investment in Ontario Quinte is excluded from income for the purpose of calculating interest coverage.

[4] Debt ratio is calculated as total debt outstanding divided by shareholder's equity plus total debt outstanding.

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expand into new businesses. We will be

What's Inside 08 Message from the Chairman 10 Message from the President and Chief Executive Officer 14 Operating Highlights 16 Environment, Health and Safety Highlights 19 Management's Discussion and Analysis 36 Consolidated Financial Statements 40 Notes to Consolidated Financial Statements 66 Four-Year Summary of Financial and Operating Statistics 68 Board of Directors 69 Board Committees 70 Senior Officers of the Company and Operating Subsidiaries 71 Investing in Our Communities 72 How to Contact Us Inside Back Cover Our New Identity

As of January 1, 2000, the company adopted a new structure with a holding company and five operating subsidiaries. The following describes each of the companies and their key priorities for 2000.

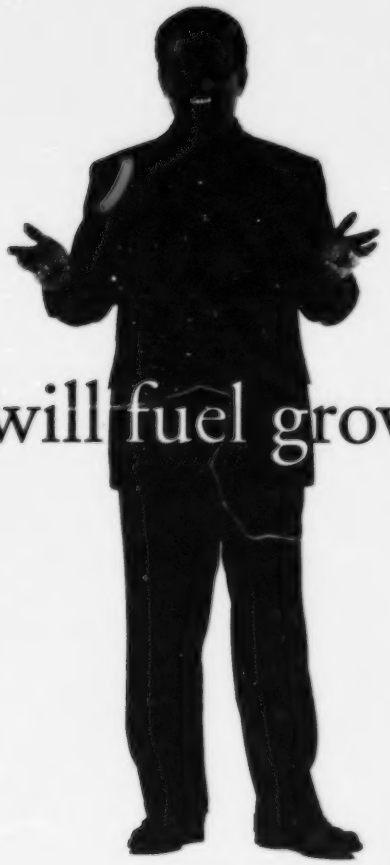
		Strategic Priorities for 2000
hydro One	**Hydro One Inc.** is a holding company involved in electricity transmission and distribution, telecom and energy services. Hydro One is a commercial successor company to Ontario Hydro and officially began operation in April 1999 under the name of Ontario Hydro Services Company Inc. In May 2000, the company name changed to Hydro One to reflect better the new business focus of the company in Ontario's evolving energy services and electricity marketplace. Hydro One and its subsidiaries have approximately 4,200 full-time employees at facilities and offices throughout Ontario, compared with 5,600 at December 31, 1999. Hydro One Inc. wholly owns five operating subsidiaries providing energy, telecom and retail services to a wide range of customers throughout Ontario.	> Create shareholder value > Pursue growth opportunit that leverage the company's core skills and assets, includ municipal wires acquisitions > Launch a subsidiary to prov competitive network services to Hydro One Networks a other utilities > Maintain favourable credit ratings > Laun the new brand
	Hydro One Networks Inc. contributes over 90 percent of total revenue to Hydro One Inc. It is the "wires business" and is responsible for the regulated electricity transmission and distribution businesses. It owns and operates Ontario's high-voltage transmission system transporting electricity to large industrial customers and municipal utilities. It also owns and operates low-voltage distribution facilities serving over 930,000 customers as well as smaller municipal utilities in the province. Hydro One Networks has approximately 4,000 full-time employees at its facilities and offices throughout Ontario, compared with 5,400 at December 31, 1999.	> Provide a solid return to the shareholder and reasona rates for customers > Achieve operational excellence a an increasingly competitive cost structure > Ensure critical systems are "open market ready" > Successfu integrate acquired distribution assets and custome > Maintain an effective working relationship with t Regulator > Demonstrate excellence in customer servi > Continue exemplary environmental stewardship
hydro one	**Hydro One Markets Inc.** will provide wholesale market settlement services to its affiliate, Hydro One Networks, to procure power for its distribution Standard Supply Service customers and competitive retailers, and to receive transmission revenues from the province's Independent Electricity Market Operator. Hydro One Markets Inc. also manages a portfolio of Non-Utility Generator (NUG) power purchase contracts for the Ontario Electricity Financial Corporation.	> Support Hydro One Networks preparations for mari opening > Upon market opening, provide efficient pov procurement and settlement services for Hydro One Netwo > Manage the transition of Hydro One's legacy responsibil for Non-Utility generation contracts
	Hydro One Remote Communities Inc. owns and manages electricity supply assets in 21 remote northern communities that are not connected to the Ontario power grid operated by Hydro One Networks. These assets include diesel generation and low-voltage distribution equipment.	> Achieve operational excellence > Demonstrate exempl environmental stewardship > Establish partnerships w First Nations' communities
	Hydro One Telecom Inc. will operate a fibre optics communications system to be leased in 2000 from Hydro One Networks, with a mandate to launch a carrier's carrier telecommunications service.	> Profitably leverage the existing fibre optic telecommuni tions asset base
OntarioHydro energy	**Ontario Hydro Energy Inc.** is an energy and services company with a goal to deliver profitable, sustainable growth. As the new competitive retail arm of Hydro One, it focuses in "beyond-the-meter" retail areas. Ontario Hydro Energy will be a supplier for all utilities billed to the home and for energy-related efficiency savings and quality improvements. In the business market, it will focus on selling services that will allow customers to optimize the benefits from competitive electricity purchasing and energy management. Services for residential customers will be marketed under the brand Onsource™, which is being launched in 2000.	> Aggressively market business energy services: Cust Solutions energy engineering service, PayOne™ consolida billing service, MeterSelect™ advanced metering servi and PowerSelect™ power quality service > Reduce co of the water heater rental program and launch value-ad residential home services > Establish a billing and databa capability for energy, products and services that will p vide the foundation for future product and service offerin > Create a network of vendors and service providers to e cute delivery of a full range of products and services w minimum fixed cost investment

customer foc ve will empowe

Going the Dist "There were days when I would call Dave Goldie's office at 7:30 a.m. and he was
my plans," stated the letter from Hydro One customer **Marg Clare. "After** 20 years wi
our cottage, the crew from the Kingston Work Centre made it happen. Dave personally
walking my property, staking and restaking the pole route." Difficult terrain and the
nts to gain access from eight property owners complicated this job for Dave G
chnician (above). So did working through both the summer bug season and icy
g out the location of the line had to meet everyone's expectations for aesth
haring between the company and the customer, and the environmental val
sessment, and ongoing consultation to accommodate everyone's interest
our customer. "There is tremendous satisfaction when we are able to
Dave. "You know that this customer will appreciate it for years to c

our employees. We will compete.

To prepare for open marke[t], ... competitively position[ed] within the larger North American market. Accommodating [un]scheduled power flows from ... across our transmission grid affects our ability to import and export power. When these flow[s] summer of 1998 and prevented numerous transactions, management moved [quick]ly to [ad]d to increase our import and export ability as the market opens to the United Stat[es]. We charged a cross-functional team with solving the problem and started [a fast]-track tripartite agreement. After the Interconnection Facilities Ex[ecution] Agr[eement] was Michigan utilities, work began on construction and installation [of] phase shifters on both U.S. sides of the Detroit River. Our construction team from the London-Sarnia area, [including] left, Paul Dales, Electrical Apprentice, Bryan Bodkin, Assistant [Gen]eral Foreman, and Electrical Foreman, is working on a tight timeframe to complete [the] new phase-shifter Lambton site in 2000. The success in negotiating, planning and constructing this [project] demonstrates how Hydro One's asset management can [be] a driver of our [business].



new business. We will fuel growth in

Targeting Strategic Growth Expanding our core power distribution business in Ontario is a key goal going into open markets. We signed our first agreement to purchase a local utility in June 1999 with the Township of Artemesia, a newly restructured and very progressive municipality. "There are three things that matter in decisions like this one – service, price and stability for our community," comments Jim Harrold, Reeve of Artemesia Township (above). "Selling to Hydro One means our residents will get enhanced services at the same rates while the capital we receive will allow us to improve and strengthen our local communities." While the Artemesia purchase adds almost 500 new customers to Hydro One, we are also negotiating with many other municipalities to purchase and operate their electrical utilities. Upon regulatory approval, these acquisitions could add significant numbers of customers to our existing customer base. As many municipalities are reviewing their electricity options under the *Electricity Act, 1998*, we are actively positioning Hydro One to be the power distribution provider of choice. These strategic acquisitions will improve the efficiency of the entire Ontario distribution system and deliver on our growth objectives.

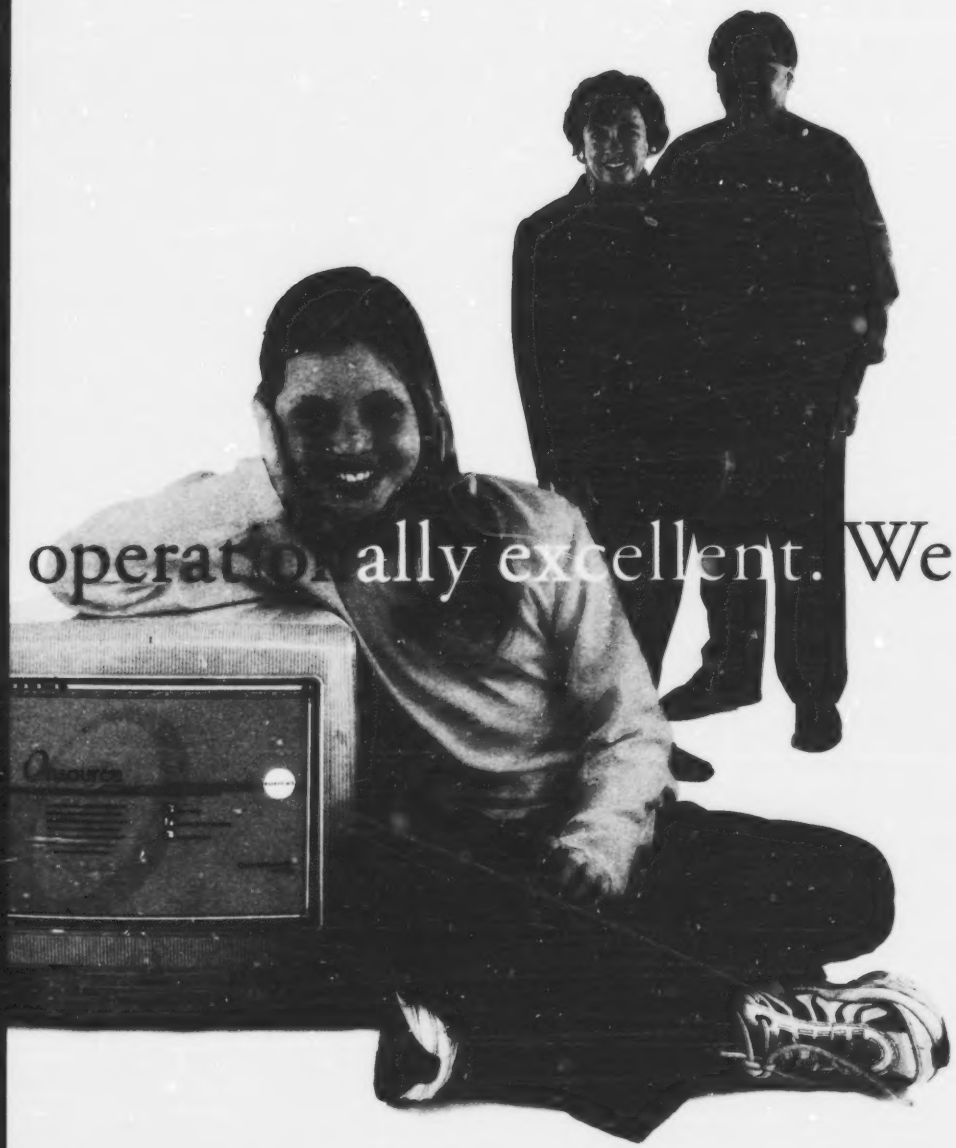
our existing business. We

Cultivating Te

Customers judge our performance largely by how well we communicate du
ns outage and how quickly we restore service. That's why only our own skilled employees operate
One's emergency outage service – 24 hours a day and seven days a week. By taking the initial ca
talking directly to our people in the Distribution Operations Management Centre, we can assess ou
rations immediately and get our on-call crews out faster. However, being a top performer ma
beyond our ability to respond to emergency situations. Improving our service on a daily basis wi
ability to be competitive in the new marketplace. Customer advocates like Denise Hunt (abo
Manager in the Customer Relations group, listen closely to the customer's service, energy or b
concerns, issues and complaints. "Customers are our best educators," says Denise. "By
concerns, they show us where we need to make improvements. We have a process in place fo
customer issues get quickly resolved involving the appropriate lines of business. Then our
complaint data, submits recommendations and partners with line management in making
improvements to ensure Hydro One will be a 'best in class' service provider."

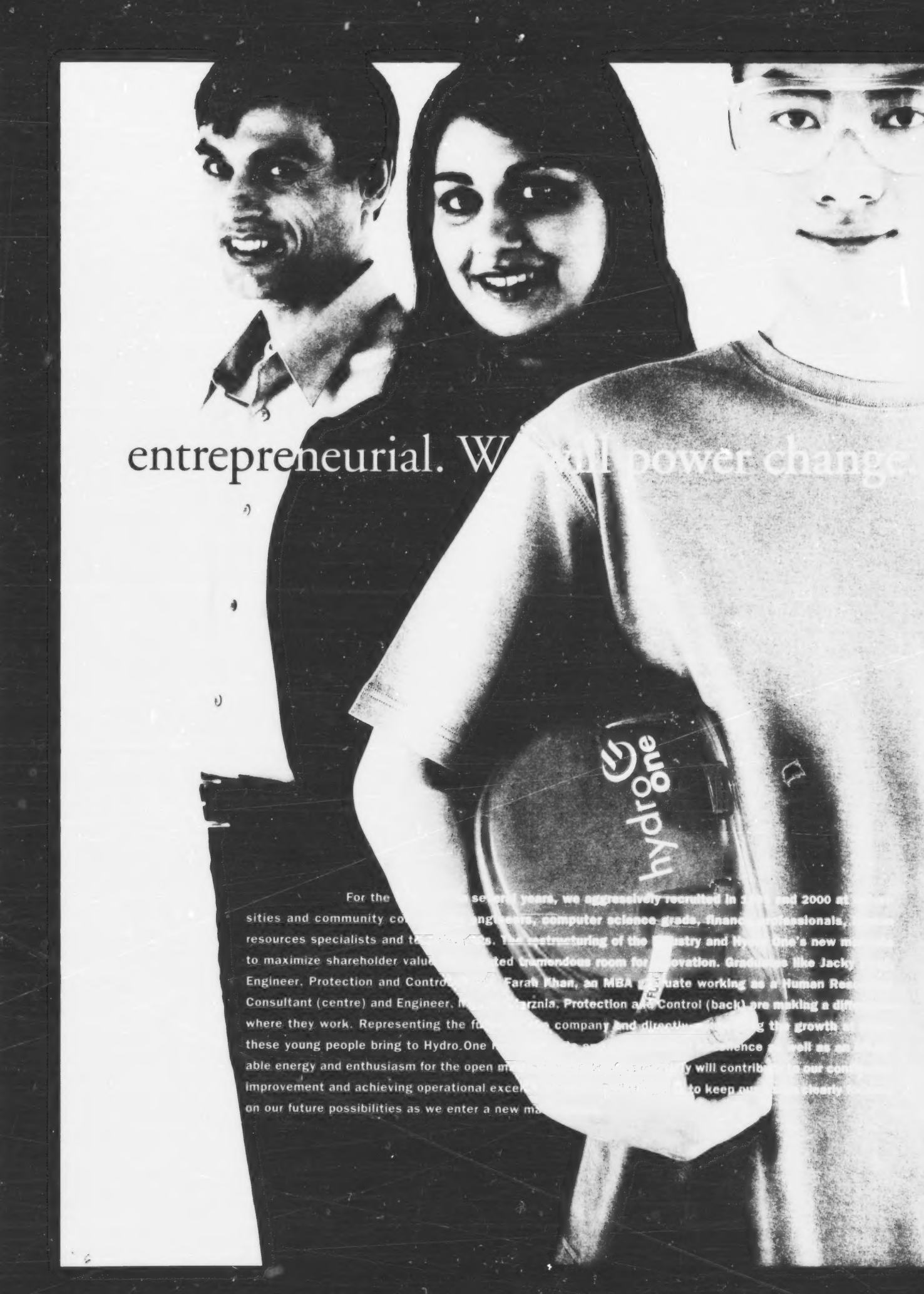
will be the be[illegible] performer. W[illegible]ll be

Maintaining Lifelines In May 1999, extremely dry spring weather conditions in the Marathon–White River region of northern Ontario caused a rash of severe forest fires. More than 100 of our staff from other communities mobilized to join crew members sent out from Thunder Bay, including Line Maintainers Dan Santerre (left) and Bill Fodchuk (right) and Journeyman Forester Marcus Steinhaeusser (centre), in battling 300-foot flames to protect the hydro poles and keep power going into our communities. In one area, we had to put back-up systems back into service and install regulators brought in from Dryden, Ontario, to keep our communities up and running. Marcus, Dan and Bill all worked up to 16-hour days, amidst the water bombers, to protect the poles that were still standing and to replace 49 structures in conditions complicated by soot, rough terrain and swamps. Helicopter support helped bring in crews and materials to the job every day. Hydro One has proven expertise in responding to a crisis, but our employees are the ones who work the long days and make the personal sacrifices. Their deep commitment to the essential service they are protecting and the lifelines they are maintaining is what makes the difference in these challenging conditions.



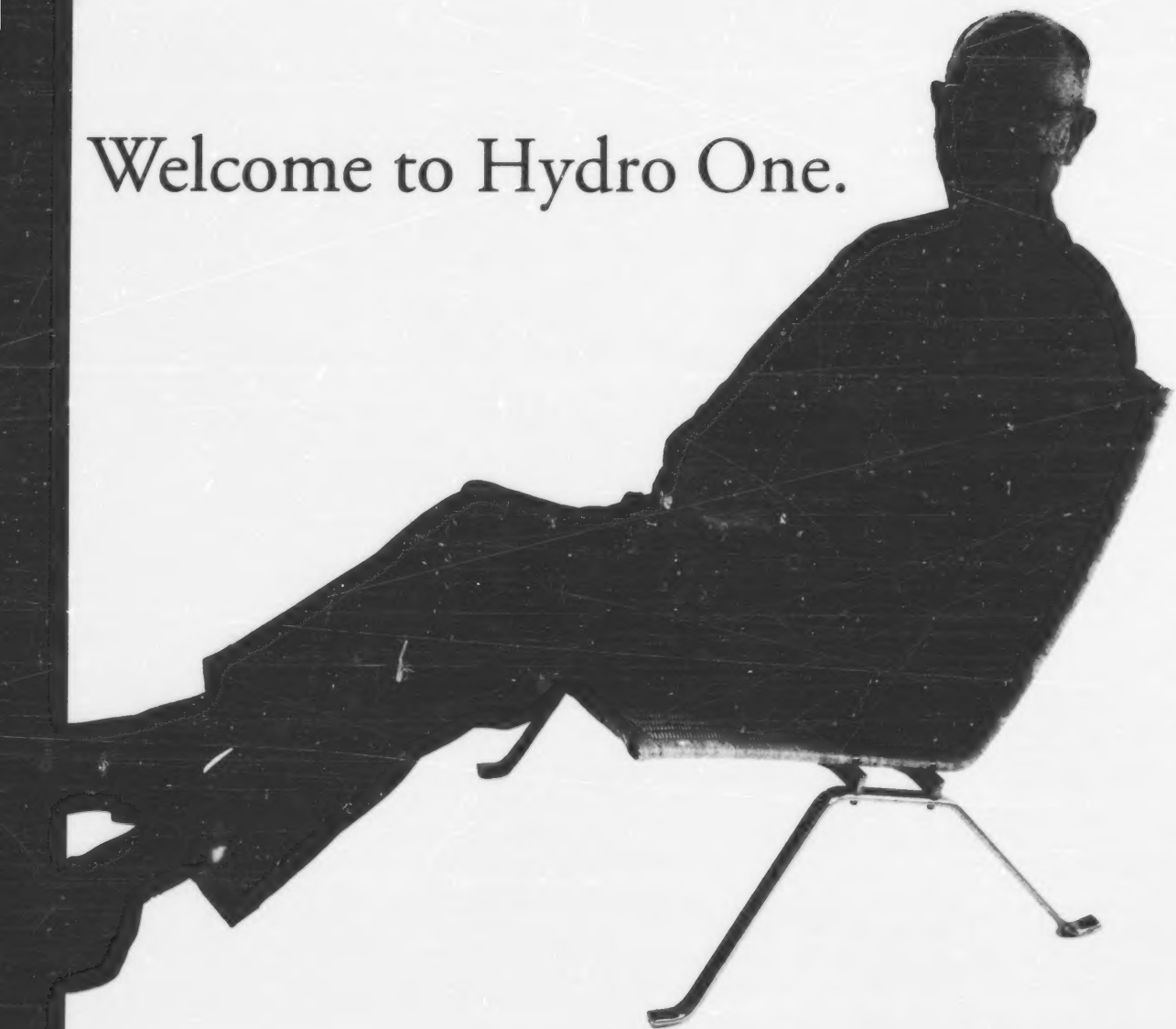
operationally excellent. We will be

Seizing Opportunities Developed by our competitive retail subsidiary, Ontario Hydro Energy, our PayOne™ service helps consolidate and manage business customer utility costs. This Internet reporting service was designed for multi-site customers such as municipalities, school boards, restaurants and the retail sector, which often have many different energy providers. "The newly amalgamated Thames Valley District School Board is one of our first customers to participate in our PayOne service. This service organizes and manages billing data and eliminates the extra costs they were incurring due to duplication of work at their sites," says Alison Knight (back left), Product Manager for PayOne. "This service already supports itself by enabling us to consolidate our larger accounts payable workload," comments John Neville (right), Manager, Operations and Energy, for the Thames Valley District School Board. "Using PayOne also gives us a database to monitor our consumption and identify energy efficiencies. Most importantly, we're passing on the savings on operating costs to improving the environment for students like Christina Ziebart (above)." Other customers participating in the successful program include Sobeys Ontario, Sears Canada and McDonald's. As the electricity market opens up, we will be extending bundled services and electronic applications under our new service, Onsource™, to residential customers as well.



For the
sities and community co
resources specialists and t
to maximize shareholder valu
Engineer, Protection and Contro
Consultant (centre) and Engineer,
where they work. Representing the fu
these young people bring to Hydro.One
able energy and enthusiasm for the open
improvement and achieving operational excel
on our future possibilities as we enter a new ma

Welcome to Hydro One.



Transition and Transformation **Hydro One is meeting a very considerable challenge, the creation of a new organization to which, appropriately, we have given a new name. The transition from a traditional utility, almost 100 years old, to a modern, competitive, cost effective business organization is that very considerable challenge.**

For Hydro One, this transformation challenge is particularly demanding as its business units were parts of a formerly integrated Ontario Hydro from which they were separated. Successfully meeting this challenge requires the development of a wholly new business focus, new systems and a new corporate culture which embraces reliability, service quality, continuous improvement and both the preservation and enhancement of shareholder value.

The attitudes and commitment of Hydro One's management and employees are delivering the required transformation. We have made considerable progress in our first year of operation, including excellent financial performance. This is only the first chapter in the Hydro One story.

Ontario and Hydro One **The November 1997 White Paper "Direction for Change", followed by enabling legislation, dramatically changed the electricity industry in Ontario. This resulted, among other things, in the formation of new companies, including Hydro One.**

Hydro One has the distinct commercial advantage of having its initial businesses located in Ontario, Canada's most populous province, where the Company benefits from Ontario's strong and growing economy and considerable industrial base.

Hydro One and its Governance **Hydro One is a company incorporated under the provisions of the Ontario *Business Corporations Act*. The Province of Ontario is Hydro One's sole shareholder.**

The initial composition of the Board of Directors combines varied and relevant skills with solid corporate, business and financial experience and diversity.

From the outset, the Board of Directors determined in its governance that Hydro One would observe all of the required and "best practice" behaviours applicable to stock exchange listed companies. This policy is reflected in the composition of the Board, the processes the Board has put in place and in the mandates and composition of the Board committees.

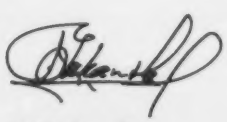
Hydro One and Regulation **Hydro One's initial businesses of electricity transmission and distribution operate in an environment where rates of return are determined by the Ontario Energy Board and where oversight of its operations is the responsibility of the Independent Electricity Market Operator.**

In late 2000, Hydro One will operate in an environment of "open access" to Ontario's electricity market and anticipates the introduction by the Ontario Energy Board of performance-based regulation. We believe that both will present opportunities for Hydro One to perform and to be rewarded for so doing.

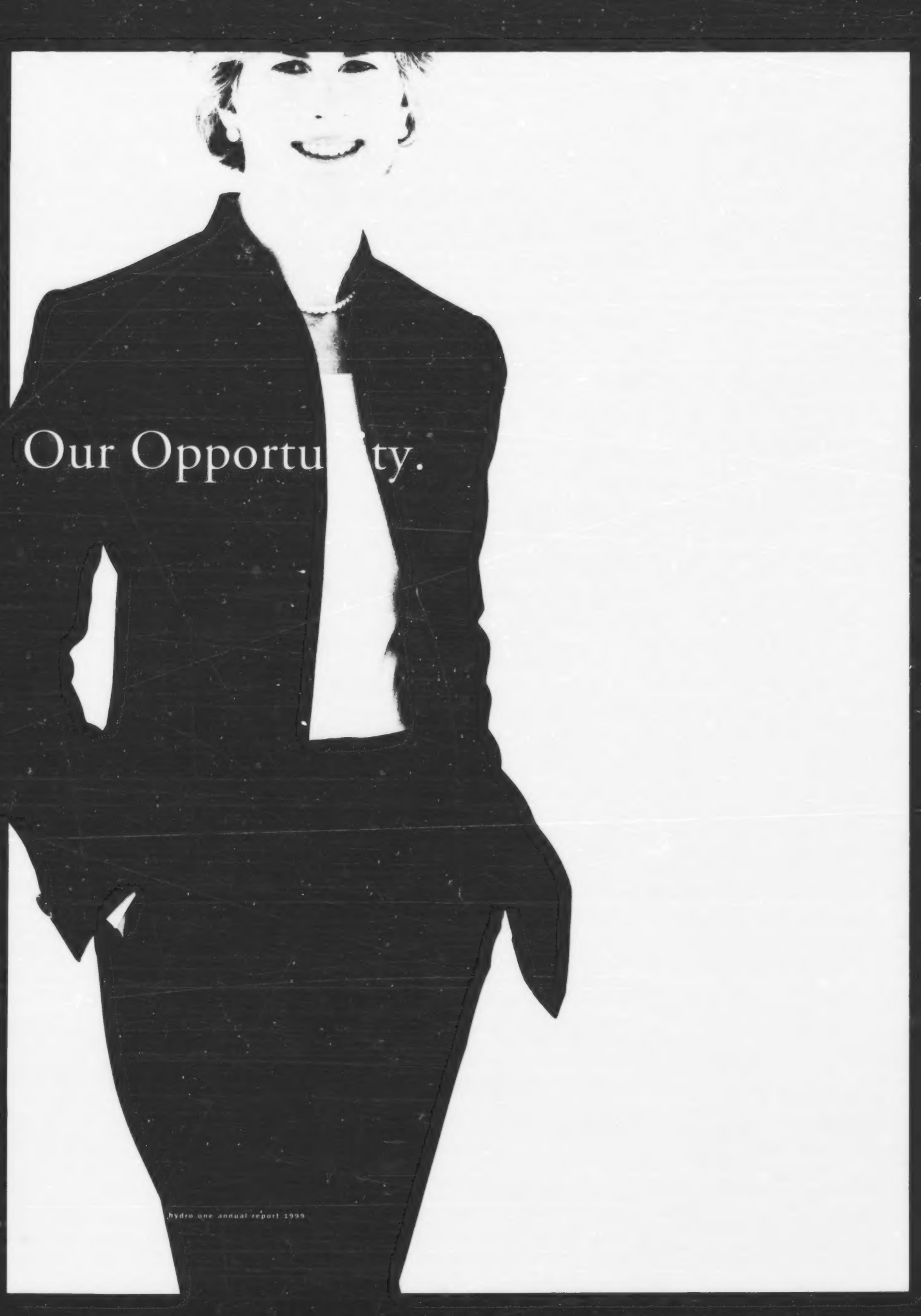
Value and Growth **Hydro One's businesses of electricity transmission and distribution are both profitable and cash generative. Our Board and management are determined to preserve and build on this value.**

Encouraged by Provincial Government policies, but subject to approval by the Ontario Energy Board, Hydro One will be acquiring selected elements of the presently fragmented municipal electricity distribution sector in Ontario. This is the Company's initial opportunity for modest profitable growth and value enhancement as economies of scale and synergies are realized and duplication is eliminated.

Into the medium and longer term, Hydro One will commercialize its fibre optic assets, enter the competitive retail market and will consider how best to develop further, deploying profitably its management and operational skills. The future for Hydro One has no present limits.



Sir Graham Day
Chairman


Our Opportu ty.

Q+A

Q At this crossroads in the restructuring of Ontario's power sector, where does the new company stand?

A We've had an exciting year seeing the vision for our new company, Hydro One, become a reality. We emerged from the industry's restructuring very focused on creating shareholder value through increasingly efficient delivery of electricity and related services. With a clear commercial mandate, we've set new priorities for capital and operating expenditures. Seizing what we regard as an exceptional opportunity to remodel, we've created a strategic vision and a growth plan for a new company – one that carries a two-fold goal of strong reliability and quality service while operating as a low-cost provider to customers. Our goal is, simply, to be "best in class".

Q What have been the difficulties in making the transition to a competitive marketplace?

A We knew where we wanted to get to, but we had to go through a transition phase in which our corporate identity and structure have been a moving target. We started the process as part of Ontario Hydro and when we separated the wires business from power generation on April 1, 1999 – the largest corporate demerger in Canadian history – we became Ontario Hydro Services Company. Nine months later on January 1, 2000, we operationalized our new structure with a holding company and five operating subsidiaries. On May 1, 2000, we introduced our new name, Hydro One, to distinguish us in this evolving marketplace. A new company, building on an over-90-year history, needs to reinvent itself totally. We now have a strategy that speaks to our core values of dependability, accountability, reliability and operational excellence as well as a promising future of growth. We're taking the best of our past and incorporating fresh approaches to help us meet our ambitious targets.

Q What progress have you made in preparing for greater competition?

A We've come a long way in a very short time. First, we strengthened our delivery platform by integrating the transmission and distribution sides of the business under our Hydro One Networks subsidiary. We're continuing to remove substantial costs from our system by integrating workforces, information systems and consolidating two fleets of vehicles. Today, our power line maintainers handle both transmission and distribution with better mobility and coverage than ever before.

Our Operational Excellence Program successfully established cross-functional processes, cycle times, productivity improvements and a performance-based system. We've made good progress on our goal of reducing costs and becoming a top-quartile performer. Next, we're working on evolving our management style to reflect a restructured market where the measures of success are quite different.

Q How will you change your approach to customers under open markets?

A We're working hard at being more customer focused in our daily work and, in turn, letting that focus change our culture. It means working to better understand customer needs today and anticipating their future requirements under open markets. Being the incumbent utility has some advantages. Our customers know and trust us. But we need to continue to challenge ourselves to innovate, and we're doing that. For example, we've grouped our customer care and information technology groups together as one unit.

12

Successfully integrating customers of the distribution properties we are acquiring is another primary element of our customer focus. We're not where we want to be when it comes to total customer satisfaction, but our research tells us we are definitely pointed in the right direction.

Q Restructuring of the Ontario power sector has opened the door to a number of opportunities for Hydro One. What strategies is Hydro One pursuing?

A At this stage of the company's evolution, we are taking a very balanced approach to growth. Our first priority is to be successful in our regulated business of Hydro One Networks, which today represents 96 percent of our revenues. We are also working to leverage our assets through operating excellence to achieve the best systems and practices at the lowest cost. As we move forward into the second half of 2000, our organization will be further evolving by establishing a subsidiary that can provide networks services to Hydro One Networks and other utilities. This will strengthen our overall competitive position by lowering costs and at the same time will enable us to market our recognized "wires expertise" to other companies. Initially, we are targeting expansion of our distribution system by acquiring distribution assets in Ontario to maximize economies of scale. And before the market opens, we are positioning Hydro One to assist competition in the North American market by strengthening our capacity to import and export electricity across our grid. While all of this is happening, we're focused on maintaining our financial strength as well as the stability and reliability of our core Ontario networks business.

Longer term, we'll leverage our core competencies of managing assets in a regulated environment and across diverse geography by applying them to natural gas and telecommunications where the business fundamentals of network management are similar. Through Ontario Hydro Energy, our competitive retail subsidiary, we're already offering our customers a number of business-to-business applications that assist with energy efficiency and usage. By the end of 2000, we intend to offer residential customers one-stop shopping for utility and telecommunications services through Onsource™.

Q What were the most significant corporate achievements during 1999?

A Number one was forging a new company in every sense of the word. The government set the schedule for the demerger on April 1, 1999, and our people met that extremely tight deadline. Beyond the sheer logistics involved in separating assets, we worked hard to breathe life into the *Electricity Act, 1998* and establish a working plan for Hydro One Networks. Our context changed dramatically – a new company operating in a new regime and a new market environment. I'm proud of how we're working with our new structure – essentially straddling two worlds simultaneously – the regulated and the unregulated.

We also integrated all aspects of distribution and transmission within Hydro One Networks. By year end, we had also made progress on the purchase of smaller Ontario utilities, signing substantially more letters of intent than we had targeted.

Q What were the financial highlights of 1999?

A One major event was the profitable sale of our investment in Luz del Sur, a Peruvian distribution utility. Another was earning $375 million in 1999 and surpassing our net income target of $348 million. We also applied for and received a transitional rate order under Hydro One Networks from the Ontario Energy Board (OEB). This transitional order gives us a solid foundation upon which to build going forward, while allowing us to operate until we have unbundled rates for transmission and distribution on November 1, 2000. As one of the first of North America's primarily energy delivery companies, the rating agencies have endorsed our fundamental strengths – a pure transmitter and distributor with a conservative financial structure, essentially no exposure to generation and commodity price risk, stable and predictable cash flow and earnings and a supportive regulatory environment. This year, we are planning to bring forward our first debt issue as a new company after obtaining preliminary high debt ratings from four credit rating agencies in Canada and the United States.

Q What were the operational challenges in 1999?

A Hydro One successfully met the Y2K challenge with 100 percent of our milestones achieved. Going into the year-end changeover, we were all confident in our Year 2000 Program and the difficult work that had

been completed. Although we believed that the rollover would have no impact on our customers, the achievement of a successful transition was very rewarding. Recreating every information system for Hydro One was another major challenge we faced last year. However, through our Operational Excellence Program we made tremendous progress. We met 110 percent of our targeted milestones, realizing productivity and efficiency gains.

Changing from a monopoly to a competitive business means radical cultural change. In December 1999, we announced a Voluntary Retirement Program (VRP) that is expected to realize savings of over $40 million per year by 2001. Over 20 percent of our employee base, a total of 1,400 employees, is leaving the company starting in the second quarter of 2000. Making the decision on the VRP was extremely difficult. We knew we would lose experience and talent, but best practices showed us we could cut costs while maintaining high levels of reliable service. This program treats departing employees fairly, and gives us excellent opportunities to remodel our company for the future.

Q Has the change in the organization affected your environmental, health and safety goals?

A As an Ontario-wide energy delivery service, our footprint is large, and we will always have an impact on the territory we serve. Having said that, our environmental performance during 1999 was on target, as we met 100 percent of all critical milestones, including establishing and operationalizing Hydro One Networks' Environmental Management System. It was also an excellent year in terms of our public safety record. In the area of employee safety, in 1999, we fell short of our target on Injury Frequency Rate, a measure tracking all incidents requiring medical attention, and we are taking steps to improve performance. We did, however, exceed our targets for reducing accident severity and lost time injuries, leaving us with a very good performance on overall safety. Safety performance is a priority for all our people in every Hydro One subsidiary and, for me personally, it is an indicator of strong management.

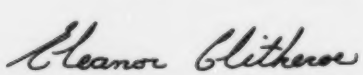
Q What are the key factors for Hydro One's success in the new marketplace?

A People are the key, together with the values they hold about our work and how it is performed. Our employees strongly identify with the vital role we play in the communities we serve. Their performance during crises such as forest fires, floods and ice storms are a testament to the depth of their dedication. I see that commitment now evolving into day-to-day operational excellence as we aim to be recognized as the best transmission and distribution utility in North America. One step to reaching that goal was our recent successful negotiation, well ahead of schedule, with the Power Workers' Union for a new collective agreement.

The strength of our management team comes from both broad experiences in the utility industry and the recent addition of top people with extensive private sector expertise spanning the retail, energy, natural resource and hi-tech industries. Together we are developing an internal culture of ownership and value-based management, focused on leadership, value drivers and accountability.

Q How does your new identity as Hydro One support future growth?

A Our new name, Hydro One, puts the customer first. It also embodies the essential nature of the service we provide and the excellence with which our front-line people deliver it. As the holding company, Hydro One's role is to develop strategy, identify acquisitions, pursue areas of growth and support our other businesses in meeting their goals. We will continue to focus on excellence in all of our businesses and grow our core transmission and distribution businesses in Hydro One Networks. As the marketplace evolves, we see a much greater contribution from growth in new business areas in which our other subsidiaries – including Hydro One Telecom, Ontario Hydro Energy and Onsource – will all participate. We're excited by the challenge of competition and applying our skills to new endeavours. Through strong leadership combined with tremendous field expertise, we have the will and enthusiasm to achieve our vision for Hydro One.



Eleanor R. Clitheroe
President and Chief Executive Officer

During 1999, Hydro One made progress preparing for the next steps in the restructuring of the electrical utilities industry and worked hard to develop a new company, including new operating agreements, following the demerger from the former Ontario Hydro. Integral to that effort, we brought together a new management team, developed our new corporate structure and established a new Toronto-based corporate headquarters. We focused on meeting customer, stakeholder and public expectations in a rapidly changing industry. In addition to initiatives that introduced new business processes and systems, the following are among our key operating accomplishments:

Open Market Ready

Wholesale and Retail Market-Ready Projects were launched across Hydro One Networks to accomplish the tasks necessary to prepare for the market opening. This involves major changes in company organization, business processes and information technology to prepare for a more competitive industry paradigm.

Customer Service

Excellent progress was made on the construction of a new underground 115-kV line that will improve electrical service for Ford Motor Company, General Motors Company and DaimlerChrysler plants in Windsor, Ontario. Work on the $26.2 million project was approximately 50 percent complete at the end of 1999 and is on schedule to be in service on September 30, 2000.

Hydro One Networks' employees connected temporary transformers for Gerdau Courtice Steel in Cambridge, Ontario, in just six hours to avoid a forced shut-down when the customer's transformer was about to fail. The quick fix allowed Hydro One to assist the customer by providing an interim solution that gave the steelmaker six months to find a new transformer without any disruption in steel production. Hydro One Networks is working with the customer on the design and engineering of a replacement transformer.

A centralized, after-hour, trouble-call-handling process was rolled out province-wide in 1999 to provide 24-hour and seven-day emergency service while improving response time and strengthening customer service.

Upgrading to Fibre Optics Capability

Excellent progress is being made to replace Hydro One Networks' older protection and control microwave radio system with fibre optics lines. The new fibre optic system will carry voice and operational control data to and from transmission stations. Once completed, it will be the backbone of our operational and administrative telecommunication systems. Any surplus fibre strands will be leased by Hydro One Telecom, which in turn will market its use to outside users. The new fibre optic system will be 25 percent completed by the end of 2000 at a cost of $69 million. The entire project will be complete by 2003.

Page 14, top to bottom: Control Room at Hydro One Networks' Transmission Operations Management Centre located in Toronto; new Phase Shift Adapter being installed at Lambton T.S. to support the Michigan-Ontario Interconnection; a fibre optic cable like the kind used by Hydro One Networks; Hydro One Networks' Line Maintainer servicing the distribution system; Eleanor Clitheroe meeting with employees during the province-wide 1999 President's Tour; Power Line Maintainer maintaining a transmission tower.

Labour Relations

In 1999, the company implemented the previously negotiated separation of the Society of Energy Professionals and the Power Workers' Union (PWU) memberships into five collective agreements, to align with the successor companies to Ontario Hydro. In addition, all employees of Ontario Hydro were allocated to one of the successor companies with no grievances. Hydro One Networks and the PWU implemented the "Hiring Hall", which was negotiated in 1998, to ensure the availability of skilled resources to Hydro One. Through this new arrangement, we have more flexibility to carry out peak electrical, mechanical, communications, civil and forestry work. Going into 2000, Hydro One and the PWU signed a new one-year agreement, which became effective on April 1, 2000. The company and the union took a mutual interest approach to bargaining rather than the traditional adversarial approach. This approach allowed us to conclude the negotiations in a record time of three weeks.

Expanding Transmission

International negotiations were completed and work is well advanced on the upgrades to the Ontario-Michigan interconnect. This project will increase import capacity by 500 MW and export capacity by 1,000 MW. It is an important first step in Hydro One's strategy to fulfil its agreement with the Market Design Committee to do everything possible to increase Ontario's ability to import electricity by 2,000 MW within three years of market opening.

Municipal Electrical Utility (MEU) Acquisitions

Hydro One entered into agreements to purchase two MEUs in 1999. By year end, the company had letters of intent or their equivalent in place with 13 other municipalities and bids in on several more MEUs. The company will pursue cost saving synergies such as integrating their electrical billing, eliminating duplications in services and removing equipment that isolates MEU distribution systems from Hydro One Networks' system, which often surrounds the MEU systems, thereby reducing line losses.

Y2K Ready

Hydro One enjoyed a successful transition to the year 2000 due to a thorough and methodical Year 2000 Program. This exhaustive effort included the remediation of over 1,500 different types of date-sensitive equipment. The company conducted the first successful, large-scale integrated time shift test in North America at its Manby Transformer Station, serving 180,000 customers in Toronto.

Employee Commitment to Serve

Hydro One Networks' line crews were applauded publicly by the customers and management of Pennsylvania Power and Light and Central Hudson Gas and Electric for their exceptional efforts during the clean-up and power restoration efforts following Hurricane Floyd. The company sent 180 employees and 80 trucks to assist in the emergency.

Page 15, top to bottom: Hydro One Networks' helicopter lifting equipment for [illegible]; Networks' forester clearing brush to maintain lands; power line maintainer working on [illegible] distribution system; a special Year 2000 Program Emergency Response Organization worker through the Manby Large-Scale Integrated Time Shift Test; Hydro One Networks' crews returning from Pennsylvania following Hurricane Floyd; Hydro One Networks' forester clearing branches away from power lines.

Establishing Principles

Health, safety and the environment are paramount to achieving our short- and long-term business performance goals. At Hydro One, our responsibility as the holding company is to establish standards and expectations of environmental performance across all of our businesses and subsidiaries. Our core principles are:

- compliance with all applicable regulations is required as a minimum
- visible leadership and accountability are required at all levels
- environmental considerations will be factored into business decisions
- performance information will be used to plan continual improvement initiatives

As a newly-established company, during 1999 we devoted our resources to developing a new Environment Policy and Environmental Management System (EMS), an Employee Health and Safety Policy and a Public Safety Policy – all of which were in place by year end.

As part of the reorganization of our corporate structure, in January 2000, the Regulatory, Health, Safety and Environment Committee was established as a committee of the Board of Hydro One Networks. Daily responsibility for managing environmental risks now resides with Hydro One Networks and Hydro One Remote Communities. By placing the committee closer to the issues, all of our policies and our EMS are more integrated into the daily activities of the wires business where 95 percent of our employees work.

Environmental Policy

At the heart of the EMS is the corporate environmental policy. The policy informs and underpins all planning, construction and operation activities. In all of our businesses, we are committed to:

- making efficient use of resources
- preventing pollution
- reducing environmental impacts and liabilities arising from our business to the extent that is reasonably achievable

Environmental Management System

The cornerstone of solid environmental performance, the EMS is the means by which Hydro One Networks and Hydro One Remote Communities operationalize our corporate environmental policy. Based on the ISO 14001 EMS Standard, our EMS ensures environmental issues are systematically identified, controlled and monitored with the goal of improving performance and meeting our environmental obligations. To support the EMS, our employees have access to the latest information through the environmental web page, as well as an EMS training package enabling our front-line trades staff to support our environmental goals.

Identifying Environmental Risks

Identifying environmental risks is integral to our EMS. It requires a systematic review of our activities, products and services to evaluate the significance of environmental risks and the adequacy of existing controls. During 1999, specific environmental management programs were developed for five previously identified significant risks as follows:

- land assessment and remediation (LAR)
- polychlorinated biphenals (PCBs)
- spills and leaks
- biodiversity
- ozone depleting substances

Land Assessment and Remediation

Our goal is to prevent any contaminated land under our jurisdiction from posing any adverse health and environmental effects on our communities, employees or business liabilities. Sites used for industrial purposes over long periods of time can become contaminated due to normal company operations – not unique to the electricity industry. Hydro One Networks has been successful in dealing with this problem by conducting site assessments and, where appropriate, undertaking remediation activities. Our strategy is to manage each situation locally to the satisfaction of each community and in accordance with environmental regulations. Our goal is to be a responsible steward of the land that has been entrusted to us to manage on behalf of our shareholder, the Province of Ontario.

Polychorinated Biphenals

We continue to make good progress in eliminating PCBs from our operations. Our PCB management program maintains inventories of all high-level PCB containing equipment as well as PCB waste and storage sites. Hydro One is working to become a PCB-free-business as soon as practicable and has already removed from service and destroyed over 80 percent of its PCBs. During 1999, 21 PCB waste storage facilities at our transmission sites were closed. By year end, very few high-level PCB materials remain in storage. Remaining inventories represent the lowest levels of contamination in our system.

Biodiversity

As a major Ontario landowner and user, we have a major responsibility to help preserve the biodiversity of the different ecosystems we traverse. Our goal is to be good stewards of the lands we occupy and to be a partner in preserving Ontario's rich biodiversity heritage. To achieve this goal, we account for biodiversity in selecting and maintaining our rights of way and developing programs to protect or enhance such ecosystems, alone or with other agencies and environmental groups.

Spills and Leaks

Our business activities involve the use of materials, such as insulating oil, gasoline and diesel fuels and low-level PCBs, that could be hazardous to human health and ecosystems if accidentally released through spills or leaks. Hydro One Networks has several initiatives underway to reduce the number and size of spills and leaks and to manage any incidents that do occur. Spill and leak containment systems are being installed on power transformers that pose the greatest potential risk to the environment. Performance is tracked to determine the effectiveness of applied measures and to plan further improvements.

Ozone Depleting Substances

Synthetic chemicals that deplete the ozone layer are gradually being phased out under the requirements of the 1987 Montreal Protocol and subsequent regulations. In support of this effort, Hydro One Networks has proactively replaced 100 percent of its halon-containing fire extinguishing systems. Air conditioning systems in older, heavy vehicles have been converted and options for doing the same for chillers and air conditioners in buildings are being evaluated to minimize disruption to business and reduce life cycle costs.

Plans for 2000

Our efforts will focus on the staged implementation of the EMS and extending our employee EMS training program. We will continue to make progress in our LAR program and PCB reduction.

Employee Health and Safety

Regardless of our business goals, safety on the job is paramount every day. Hydro One's Employee Health and Safety Policy, developed in 1999, sets the standards for our corporate health and safety performance.

In 1999, Hydro One Networks reported 89 incidents per million hours worked compared to 82.7 incidents per million hours in 1998. There were also 67 lost time injuries that resulted in 844 days lost compared to 62 injuries in 1998 that caused 1,420 days to be lost in 1998. Good progress was made on the early and safe return to work program as reflected in the reduction in days lost. Our focus is accident prevention through addressing the root cause of incidents with a goal of systematic elimination of serious or potentially serious incidents and accidents.

Highlights for the year include:

- participation in the University of Waterloo Back Injury Prevention Study
- development of the Forestry Multi-Worksite Joint Health and Safety Agreement
- implementation of the Work Protection Code

Public Safety Policy

Our Public Safety Policy was developed in 1999. Public safety is a core value for Hydro One and the delivery of products and services in a safe manner is a priority. In 1999, the number of inadvertent public electrical contacts resulting in fatalities was one, down from four in 1998. We are committed to public awareness of safety issues related to our facilities as well as to promoting and encouraging the safe use of electricity by our customers.

Reporting Our Accountabilities

We encourage readers to request a copy of Hydro One Networks' Environment, Health and Safety Report for a more detailed account of our environmental initiatives and health and safety performance.

Financial Review 19 Management's Discussion and Analysis 34 Management's Report 35 Auditors' Report
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Operating Statistics 65 Board of Directors 66 Board Committees
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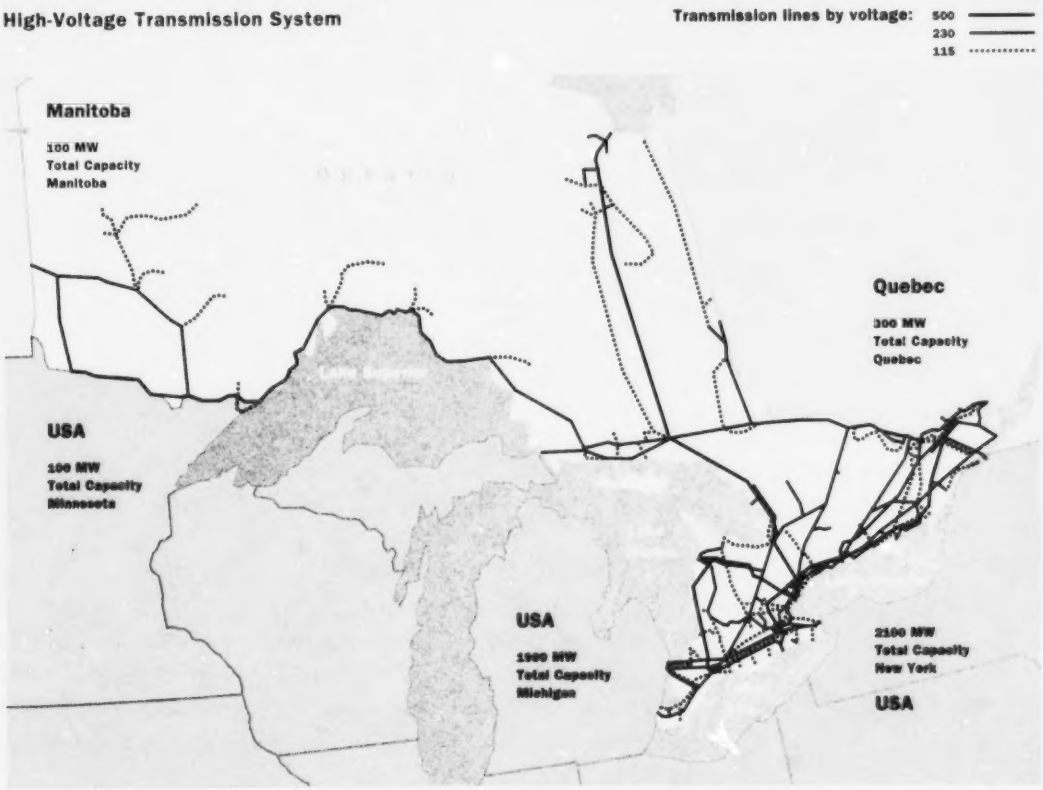
Our Company, together with its subsidiaries, owns and operates one of the largest electricity high-voltage transmission systems and low-voltage distribution systems in North America. We acquired our transmission, distribution and energy services businesses of Ontario Hydro on April 1, 1999, as part of the major restructuring of Ontario's electricity industry. Restructuring and deregulation of the electricity industry has been taking place throughout North America over the past few years. The industry is moving toward more competitive market models that are intended to encourage increased responsiveness to customers and market conditions. We are a separate company, preparing to compete in Ontario's wholesale and retail electricity markets, which are expected to become open to competition. Mechanisms have been put in place by the Province of Ontario (the Province), including the establishment of the Independent Electricity Market Operator (IMO) and a broadened mandate for the Ontario Energy Board (OEB), to ensure that deregulation proceeds in an orderly manner.

High-Voltage Transmission System



Transmission

Our transmission business owns and operates approximately $6.7 billion of assets, comprised primarily of Ontario's high-voltage transmission system. During 1999, 144.1 TWh of electricity was transmitted through a 28,900-kilometre network to distributors and large industrial companies. This business serves 66 municipal electricity utilities, our own distribution system and 67 large industrial customers. We also own and operate 17 interconnection facilities that connect our transmission system with systems in neighbouring provinces and U.S. states.

Distribution (including retail)

Our distribution business owns and operates approximately $3.4 billion of assets, comprised primarily of a 113,400-kilometre low-voltage distribution network. During 1999, 18.1 TWh of electricity was transmitted through this network to customers located throughout the Province. Customers of this business include 189 small municipal electricity utilities, 39 large industrial customers and about 934,000 retail consumers consisting primarily of seasonal, rural and northern customers.

Within the distribution service areas, we are also a retailer of electricity. We purchase electricity for delivery to customers and also provide rental, repair, meter-reading, billing and collection services. We also operate a generation and distribution system in 21 remote communities across northern Ontario that are not connected to Ontario's electricity grid. These facilities are owned either by us or by the Ontario Electricity Financial Corporation (OEFC).

Regulation

Our transmission and distribution businesses are regulated by the OEB. Under the *Ontario Energy Board Act, 1998*, the OEB was granted increased powers and responsibilities to regulate the electricity industry. The OEB has the power to approve or fix rates for the transmission and distribution of electricity, the power to provide continued rate protection for rural and remote electricity consumers and the responsibility for ensuring that distribution companies fulfill obligations to connect and service customers. Prior to April 1, 1999, Ontario Hydro was governed by the *Power Corporation Act*, which provided it with broad powers to generate, supply and deliver electricity throughout Ontario.

The OEB issues rate orders that establish planned revenue levels (revenue requirements) for the transmission and distribution businesses. The revenue requirements are designed to permit these regulated businesses to recover allowed, or approved, costs of these businesses and to earn a specified rate of return.

The transitional rate orders approved by the OEB for 1999 allow the transmission and distribution businesses to earn a forecasted annual rate of return of 9.35% on an average common equity of approximately $2.9 billion deemed, for regulatory purposes, to be allocated to these businesses. For 2000, the OEB adjusted the rate of return to 9.88% to reflect higher forecasted interest rates. It is anticipated that future rate orders will incorporate a performance-based regulation methodology, which may allow us, as well as our customers, to benefit from cost control initiatives without jeopardizing service quality.

"At Hydro One, we begin with most of the assets of Ontario's power transmission business – but only about one-third of Ontario's power distribution lines. So we want to play an important role in rationalizing the distribution sector in the Province. Both businesses are regulated by the Ontario Energy Board, and we want to work with the regulator to show we can get scale efficiencies that will benefit our customers. Our strategic vision is to leverage our Ontario wires footprint, to become a major energy delivery business in northeastern North America."

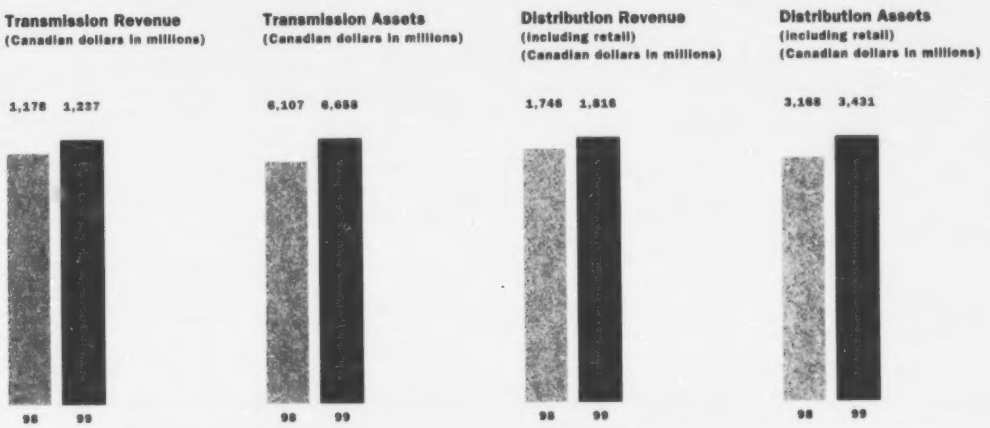
Rod Taylor
Executive Vice President, Planning and Development
Hydro One Inc.

In accordance with the transitional distribution rate order, electricity will be sold at pre-existing retail rates within current service areas until the introduction of Open Access or March 31, 2001, whichever is earlier. Open Access will begin when transmitters and distributors are required to provide generators, retailers and consumers with non-discriminatory access to their transmission and distribution systems in Ontario, according to the *Electricity Act, 1998*. Under Open Access, our customers will be free to choose their electricity supplier. The Province will determine the date that Open Access begins.

Results of Operations

The Consolidated Financial Statements include the results of operations and financial position for periods prior to the acquisition date of April 1, 1999, when our business was conducted by Ontario Hydro. The historical results may have been different had the operations been conducted as a stand-alone corporation, rather than as a business unit of Ontario Hydro. As a result, the financial statements might not be indicative of future financial performance. Results for the period beginning April 1, 1999, reflect a new regulatory system and capital structure. See Note 3 to the Consolidated Financial Statements.

The following discussion of our results of operations for 1999 is based on the combined results for the twelve months ended December 31, 1999, consisting of the three months ended March 31, 1999, relating to the period prior to our acquisition of substantially all of the assets, liabilities, rights and obligations of Ontario Hydro's transmission, distribution and energy services businesses as of April 1, 1999, and the nine months ended December 31, 1999, relating to the period after that date. Among other things, this combined twelve-month period fully reflects the transitional rate orders, which were applicable for the entire year ended December 31, 1999. As a result, the following discussion of our results of operations compares the combined twelve months ended December 31, 1999, with the year ended December 31, 1998.



Net Income

Net income of $375 million in 1999 increased by $105 million, after excluding a credit of $204 million to results of operations in 1998 related to the revaluation of the deferred pension asset. This increase was primarily due to a reduction of approximately $111 million in the costs of the distribution (including retail) business, and a gain of $22 million, after payments in lieu of corporate income taxes, on the sale of our investment in Ontario Quinta A.V.V. (Ontario Quinta), partially offset by a gain of $30 million in 1998 on the sale of surplus land.

The reduction in the costs of the distribution (including retail) business was primarily attributable to a reduction in financing costs resulting from our recapitalization and the reduction in operation, maintenance and administration costs related to the January 1998 ice storm. An increase in other costs of the distribution (including retail) business, including payments in lieu of corporate income taxes and other operation, maintenance and administration costs, was largely offset by a decrease in the cost of purchased power and an increase in revenue provided for under our transitional rate orders.

Net income for our regulated transmission and distribution businesses was broadly in line with the annual rate of return of 9.35% provided for in our transitional rate orders for 1999. This rate of return was based on average common equity of approximately $2.9 billion during the year deemed, for regulatory purposes, to be allocated to these businesses.

Revenues

Revenues increased by $77 million, or 3%, to $3,125 million for the year ended December 31, 1999, due to the factors discussed below.

Transmission

Transmission revenues increased by $59 million, or 5% over 1998, to $1,237 million. Revenues increased by $67 million due to higher allowed costs provided for under the transitional rate order for our transmission business. Revenues also increased by $26 million primarily due to the inclusion of sales of maintenance, engineering and telecommunication services to other Ontario Hydro successor corporations. These sales were partially offset by a $12 million reduction in the demand, primarily from other Ontario Hydro successor corporations, for marketing and sales services related to the disposition of surplus equipment, materials and supplies to third parties. Transmission revenues for 1998 included a $30 million gain on the sale of surplus land.

Distribution (including retail)

Distribution (including retail) revenues for 1999 increased over the prior year by $70 million, or 4%, to $1,816 million. Revenues increased by $89 million due to higher allowed costs provided for under the transitional rate order for our distribution business. Retail revenues rose by $50 million primarily due to an increase in the demand for electricity of $67 million, partially offset by a $17 million reduction in rates, primarily from a shift in the mix of rate groups. The demand for electricity increased as a result of weather and economic growth. Revenues also increased by $33 million due to the inclusion of sales of services to retail customers, other utilities and other Ontario Hydro successor corporations. These increases were partially offset by a $102 million reduction in revenues due to a number of municipal electricity utilities acquiring, through annexation, some distribution assets and customers in areas previously served by us. The ability of municipalities to annex areas previously served by us ceased as of April 1, 1999. See Note 10 to the Consolidated Financial Statements.

Other

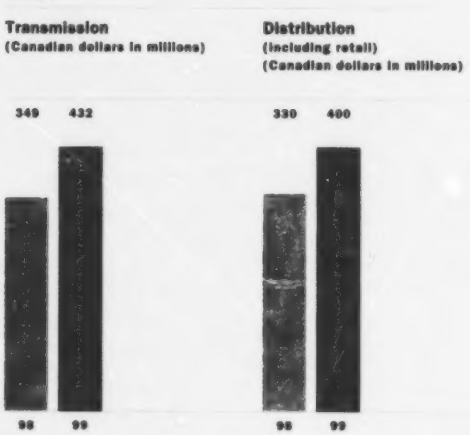
Other revenues declined by $52 million, or 42%, to $72 million during 1999. These revenues were primarily derived from the activities of our wholly-owned subsidiary, Ontario Hydro International Inc. (OHII). As part of our strategy, the operations of OHII are currently being wound up. On September 15, 1999, OHII sold its investment in Ontario Quinta. See Note 7 to the Consolidated Financial Statements.

Costs

Operation, Maintenance and Administration

Operation, maintenance and administration (OM&A) costs are comprised primarily of labour, material, equipment and purchased services in support of the operation and maintenance of the transmission and distribution systems. In addition, OM&A includes property taxes, and prior to April 1, 1999, grants in lieu of property taxes, which are paid to municipalities and to the Province on our lines, stations and buildings. In addition, as of April 1, 1999, we are required to make payments in lieu of capital taxes to OEFC. OM&A in 1999 also includes a net charge of $24 million which is comprised of a $60 million charge associated with a staff reduction program, partially offset by the reversal of provisions no longer required in the amount of $36 million as discussed on page 24 under Staff Reduction Program and Reversal of Prior Provisions. Total OM&A increased by $140 million, or 19% over 1998, to $863 million in 1999 due to the factors discussed below.

OM&A



Transmission

Transmission OM&A increased by $83 million, or 24%, to $432 million. Expenditures were $23 million higher in 1999 primarily due to work programs, such as environmental management, rights of way maintenance and telecommunications. Environmental costs include land assessment and remediation as well as PCB removal and destruction. Rights of way expenditures relate to the clearing of vegetation around transmission lines and stations. Telecommunication expenditures are made to support the aging analog microwave radio system. These program costs were partially reduced by the effect of approximately $2 million in costs related to the January 1998 ice storm. OM&A also increased by $25 million due to the provision of services to other Ontario Hydro successor corporations, partially offset by the reduction of services to third parties. Property taxes and related payments increased by $18 million, including a new levy of $8 million paid to OEFC in accordance with the *Electricity Act, 1998*. Payments in lieu of capital taxes, which commenced April 1, 1999, amounted to $14 million. Transmission OM&A also includes a net charge of $5 million, which consists of a $33 million charge associated with the staff reduction program, partially offset by the reversal of an earlier staff reduction provision in the amount of $6 million and a provision for some real estate costs in the amount of $22 million.

"Under our operational excellence program, we successfully introduced measures to consolidate work centres, redesign processes, divest of low-value services and identify the most cost-effective suppliers while also improving labour productivity and initiating incentive-based compensation. The improvements we were able to make in customer care are directly related to top management's support for information technology as a strategic enabler. The investment in systems gives us a solid platform for operating our business as we move forward."

Kathryn Beaton
Vice President and General Manager, Customer Relations
Hydro One Networks Inc.

Distribution (including retail)

Distribution (including retail) OM&A increased by $70 million, or 21%, to $400 million. Additional work program costs of approximately $60 million were incurred primarily on trouble calls related to power restoration, vegetation management, the start-up of a pilot project to enhance outage management and line and station maintenance. Vegetation management includes tree trimming and brush control to maintain adequate clearance for electrical supply facilities. Costs associated with the pilot project for outage management primarily relate to the collection of detailed asset information. A key initiative associated with the line maintenance program was the replacement of wood pins and insulators with components that have lower failure rates. Increased land remediation efforts occurred at our distribution stations. These program costs were substantially reduced by the effect of approximately $41 million in costs included in 1998 results of operations that were related to the January 1998 ice storm. These costs did not recur in 1999. Costs of $24 million were incurred to provide services to retail customers, other utilities and other Ontario Hydro successor corporations. Payments in lieu of capital taxes, which commenced April 1, 1999, amounted to $8 million. Distribution (including retail) OM&A also includes a net charge of $19 million which consists of a $27 million charge associated with the staff reduction program, partially offset by the reversal of an earlier staff reduction provision in the amount of $8 million.

Staff Reduction Program

In November 1999, our Board of Directors approved a staff reduction program intended to reduce cost levels in 2000 and subsequent years. We achieved this staff reduction through a voluntary retirement program, supplemented by targeted voluntary buyouts. The voluntary retirement program allowed qualifying staff to retire when combined age and service reached 75 years during 2000. Employees who accepted this offer, which closed on March 31, 2000, could retire with an unreduced pension and either a five-year pension credit or a three-year pension credit plus a payment equal to six months' salary. Approximately 1,400 employees accepted early retirement under the program, which was broadly in line with our estimate. Most of the costs for the staff reduction program will be funded from our pension plan surplus. The funding impact on the pension surplus is expected to range between $240 million and $270 million. We also recognized a $60 million charge to 1999 results of operations related to the staff reduction program. This amount consisted of approximately $40 million for cash incentives payable under the voluntary retirement plan, approximately $10 million for supplementary pension benefits that cannot be charged to pension surplus and approximately $10 million for targeted buyouts. We expect that these provisions will be used during 2000 with a small amount being used in early 2001.

Reversal of Prior Provisions

In addition, at year end 1999, we re-evaluated the need for some provisions previously recognized by Ontario Hydro and assumed by us as of April 1, 1999. These provisions related to involuntary staff reduction costs and some future real estate costs. Ontario Hydro had recognized in 1997 a $21 million provision for involuntary staff reduction costs related to the businesses acquired by us as of April 1, 1999. This amount included

$3 million related to corporate and administrative employees allocated to us as of that date. The provisions recognized by Ontario Hydro in 1997 were based on the estimated future cost of terminating specific numbers of staff under applicable collective agreements. Approximately $6 million was charged to this provision in 1998 and $1 million was charged in 1999. As further staff reductions will be carried out under our company's new voluntary staff reduction program and using targeted buyouts, we will not use the remaining $14 million. As a result, this amount was reversed as a credit to results of operations in 1999.

The real estate provisions were originally recorded by Ontario Hydro in 1993 and related to approximately $9 million in estimated future post-occupancy costs. We now expect that the costs provided for in 1993 will not be incurred due to a change in market and other business conditions in 1999. We also assumed a $13 million provision originally recognized by Ontario Hydro in 1993 for post-occupancy costs related to several other surplus real estate properties that were previously expected to be sold with no gain. We reviewed this provision in late 1999 and determined that some of the properties will now be retained and that those properties to be sold are now likely to result in a gain. As a result, the post-occupancy costs can be offset against proceeds of disposition. A total of $22 million related to real estate costs accrued by Ontario Hydro in 1993 was reversed by us as a credit to results of operations in 1999.

Other

Other OM&A decreased by $13 million, or 30%, to $31 million in 1999. The activities of OHII are currently being wound up and our investment in Ontario Quinta was sold during the year.

Purchased Power

Purchased power costs declined by $226 million compared with 1998, or 19%, to $939 million. Approximately $190 million of this reduction reflected a lower cost for the energy we delivered in 1999. Purchased power costs also decreased by $56 million due to the annexation by municipal electricity utilities of areas that we previously served. Purchased power costs further declined by $28 million as a result of the sale of our investment in Ontario Quinta in September 1999. These decreases were partially offset by a $48 million increase in purchases due to higher sales to our remaining customer base.

Depreciation and Amortization

Depreciation and amortization expense increased by $42 million, or 14% over 1998, to $342 million, primarily due to the amortization of regulatory assets. Ontario Hydro adopted accrual accounting for its other post-retirement and post-employment benefits in 1997, and in 1998 changed the discount rate used to measure these liabilities from a long-term average rate to a current market settlement rate in anticipation of new accounting recommendations to be issued by the Canadian Institute of Chartered Accountants. The OEB approved a regulatory asset to provide for the recovery of these liabilities over a 10-year period on a straight-line basis. The amortization related to this regulatory asset during the year amounted to $32 million. The OEB also approved the recovery of certain costs charged to operations by Ontario Hydro in 1997. The amortization related to this regulatory asset amounted to $20 million. The increase in depreciation and amortization related to these regulatory assets was partially offset by other items such as the impact of $7 million related to a lengthening of service lives and the gain of $7 million on a minor sale of real estate.

"Our workforce has proven they can successfully ride to the rescue and perform heroic efforts during hurricanes, floods and fires. The challenge we face now at Hydro One Networks is day-to-day operating improvements with constant attention to employee and public safety. The gains we expect to realize are largely in the minds and hands of our front-line employees – the primary source of innovation in our business."

Courtney Pratt
President and Chief Executive Officer
Hydro One Networks Inc.

"Under our new business model for transmission and distribution, we're centralizing our asset management and asset maintenance programs. We're also setting province-wide standards and priorities for how we get the work done. We continue to focus on meeting such important considerations as customer satisfaction, safety and expectations for good environmental performance. Most importantly, we're counting on our skilled front-line employees to manage and execute the work in the field to create savings and delivery improvements."

Ron Stewart
Chief Operating Officer
Hydro One Networks Inc.

Transitional Cost Adjustment

The transitional cost adjustment amounted to $55 million for the three months ended March 31, 1999, and represents the difference between allowed costs specified in the transitional rate orders approved by the OEB and costs that were allowed under the *Power Corporation Act*. The transitional cost adjustment constitutes a one-time charge.

Provincial Debt Guarantee Fee

The Province does not guarantee our debt. Prior to April 1, 1999, however, the Province did guarantee the debt of Ontario Hydro, which was partially secured by assets that we acquired. The elimination of this guarantee resulted in a $23 million reduction in the provincial debt guarantee fee compared with 1998.

Deferred Pension Asset

In accordance with the provisions of the *Electricity Act, 1998*, Ontario Hydro recorded an increase in the value of the deferred pension asset, with a corresponding credit of $204 million to 1998 results of operations. Specifically, the provisions of the *Electricity Act, 1998*, allow our Company to reduce employer contributions to the pension fund to the extent permitted under the *Pension Benefits Act* when the plan has a surplus. In addition, contributions made by Ontario Hydro for the normal costs of the pension plan in respect of service after March 31, 1998, were refunded.

Gain on Sale of Investment

On September 15, 1999, our subsidiary, OHII, sold its 25% equity interest in Ontario Quinta. At the time of sale, Ontario Quinta held a 60% interest in Luz del Sur S.A.A., an electricity distribution company serving southern Lima, Peru, and a 64% interest in Tecsur S.A.A., a utility maintenance and construction company also operating in Peru. We realized a gain of $32 million on this sale.

Financing Charges

Financing charges declined by $178 million, or 32%, to $381 million during the year. This decrease primarily reflects a reduction of $131 million resulting from lower levels of debt and a reduction of $47 million due to a decline in the weighted average interest rate from 9.0% in 1998 to 7.7% in 1999. The lower levels of debt

"We see a lot of opportunity to grow by leveraging our existing assets and competencies and moving them selectively into the competitive arena. Hydro One Telecom, our new telecommunications arm, is a case in point. It will lease excess capacity on Hydro One Networks' fibre optic system and in turn rent dark and lit fibre capacity to telecom service providers."

Joan Prior
President and Chief Executive Officer
Hydro One Telecom Inc.

reflect the new capital and debt structure established on April 1, 1999, in conjunction with the acquisition of substantially all of the assets, liabilities, rights and obligations of Ontario Hydro's electricity transmission, distribution and energy services businesses. Prior to April 1, 1999, financing charges represented the interest and expenses associated with the allocated portion of Ontario Hydro's debt.

Provision for Payments in Lieu of Corporate Income Taxes

The provision for payments in lieu of corporate income taxes totalled $194 million during the year. Under the *Electricity Act, 1998*, we are required to make these payments in lieu of corporate income taxes to OEFC based on our results of operations beginning on April 1, 1999.

"In structuring Hydro One, we aligned our business processes and planning to meet both the regulatory requirements and the expectations of our employees, customers and other stakeholders. We value a positive and open relationship with the Ontario Energy Board and are supportive of their efforts to encourage changes in regulations that provide rewards for performance. Under performance-based regulation, more efficient companies like Hydro One Networks can share gains beyond awarded returns with their customers and shareholder, a structure that better simulates competitive markets."

Mike Bermon
Senior Vice President, Regulatory and Governmental Affairs
Hydro One Networks Inc.

Liquidity and Capital Resources

Liquidity and Capital Resource Requirements

Capital Expenditures

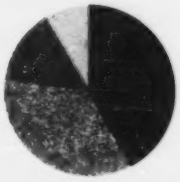
Findings from a review of the condition of assets indicate that Ontario Hydro had declining and inadequate preventative maintenance programs. Spending on asset maintenance had been deferred as available funds were allocated to other business units of Ontario Hydro. Capital expenditures must be made in order to safeguard the long-term reliability of our asset base. Investments are also required to enable us to expand our market and to pursue our objective of reducing costs. Total capital expenditures were $529 million in 1999 compared with $394 million in 1998.

Capital Expenditures

Transmission
Year ended December 31, 1999
(Canadian dollars in millions)

Sustainment	182
Expansion	101
Operations Support and Enhancement	44

Distribution (including retail)
Year ended December 31, 1999
(Canadian dollars in millions)



Sustainment	82
Expansion	69
Operations Support and Enhancement	39
Other	17

Capital expenditures for the transmission business were $327 million in 1999 and $171 million in 1998. Increased capital expenditures were made primarily on transmission station and line refurbishment, telecommunications and expansion activities. Approximately $182 million was spent in 1999 to maintain the existing infrastructure and facilities, including the completion of phase one of the microwave radio system replacement. Over the next several years, the remainder of the analog microwave radio system covering southern Ontario will be replaced with a digital system. Investments in expansion programs to meet the growing demands of new and existing customers amounted to $101 million in 1999. Significant projects include the installation of three phase-shifting transformers and an autotransformer at the interconnection with the State of Michigan and the construction of a dedicated transmission service to the auto industry in the Windsor area. Capital expenditures in 1999 also include $44 million primarily related to information technology projects to support operations, increase efficiency and reduce costs. These projects include the construction of the Transmission Operations Management Centre, the consolidation of dispersed operating centres, upgrades to the supervisory control and data acquisition equipment, and the acquisition of new network management systems.

Capital expenditures for the distribution business (including retail) were $196 million in 1999, consistent with 1998. Increased capital expenditures primarily for new customer connections, service upgrades, relocation of assets due to road construction and outage management were offset by a reduction of $49 million associated with the January 1998 ice storm and $14 million in non-recurring development costs associated with the customer service system. Capital expenditures related to the existing asset base amounted to $82 million and primarily include the rehabilitation or replacement of poles, conductors, transformers and cables. Another $69 million was spent connecting new customers and upgrading existing distribution facilities. Expenditures to support operations and to enhance efficiency and reduce costs amounted to $28 million and include a pilot project to improve outage management and various projects to integrate supporting information systems. In addition, $17 million was spent in 1999 to support the retail operations within the distribution service areas and the generation and distribution system in remote communities.

Capital expenditures for other operations were $6 million in 1999 compared to $28 million in 1998. The reduction from 1998 levels is a result of OHII currently being wound up.

Capital expenditures are budgeted at $510 million in 2000. The budget for our transmission business is $291 million, a reduction of $36 million from 1999 expenditures. Expansion programs will be reduced due to the completion of various projects, including the interconnection project with the State of Michigan. This reduction will be partially offset by asset sustainment activities, including the phase two replacement of the microwave radio system. The budget for our distribution (including retail) business is $219 million, an increase of $23 million over 1999 expenditures. The distribution (including retail) budget reflects increased focus on growth activities such as the acquisition of municipal electricity utilities and continuing preparation for Open Access, partially offset by reductions in asset condition work.

"As the first of a new breed of pure wires companies, the preliminary debt ratings for our company received from the credit rating agencies were very positive. These preliminary ratings exceeded our targets and reflect the strong financial position of our electrical distribution and transmission business."

Malen Ng

Executive Vice President and Chief Financial Officer
Hydro One Inc.

Servicing Indebtedness

In exchange for substantially all of the assets, liabilities, rights and obligations of the electricity transmission, distribution and energy services businesses of Ontario Hydro, we issued unsecured senior notes to OEFC totalling $4.85 billion, together with an additional promissory note in the principal amount of $3.76 billion. The Province assumed the obligations, including interest accrued from April 1, 1999, under the additional promissory note in conjunction with the issuance of common and preferred shares on March 31, 2000. We may, at our option, prepay at any time all or part of the notes. The notes bear interest at various rates, with a current weighted average interest rate of 7.7% per year, and mature between 2000 and 2007. The notes due in 2000 total $1,399 million, including $749 million on which payment may be deferred to March 30, 2001, at our option. We may be required to issue additional debt to OEFC for potential post-acquisition adjustments related to the subsequent verification of assets and liabilities purchased on closing. See Notes 3 and 18 to the Consolidated Financial Statements.

"We've spent our first year of operations working with the industry's new rules and policies while at the same time preparing for the changes and opportunities presented by the opening of the market. We are working together to build a solid base to meet changes and developments in our legal and regulatory framework while honing the skills required for joint ventures and partnerships. The strength of our teamwork is what makes it happen."

Laura Formusa
General Counsel and Secretary
Hydro One Networks Inc.

Payment of Dividends

The preferred shares issued on March 31, 2000, are entitled to a total annual cumulative dividend of $18 million, which is payable on a quarterly basis. The declaration and payment of dividends on our common shares are declared at the sole discretion of our Board of Directors, as recommended by management based on results of operations, financial condition, cash requirements and other pertinent factors such as industry practice and shareholder expectations. In accordance with resolutions made by our Board of Directors, in respect of the nine months ended December 31, 1999, $13.3 million in preferred dividends and $158 million in common dividends became payable to the Province, for a total of $171.3 million. See Note 18 to the Consolidated Financial Statements.

Payments in Lieu of Corporate Taxes

Under the *Electricity Act, 1998*, we are required to make payments in lieu of corporate taxes to OEFC, commencing April 1, 1999. These payments are calculated in accordance with the rules for computing income and taxable capital and other relevant amounts contained in the *Income Tax Act (Canada)* and the *Corporations Tax Act (Ontario)* as modified by the *Electricity Act, 1998*, and related regulations.

Sources of Liquidity and Capital Resources

Cash Provided by Operations

Cash provided by operations was $794 million in 1999 as compared with $520 million in 1998. This increase of $274 million reflects higher net income (after adjusting 1998 income for the revaluation of the deferred pension asset), higher accounts payable and accrued charges as well as higher accrued interest, following the initial capitalization of our company on April 1, 1999. Accounts payable and accrued charges include amounts for power. Ontario Hydro, prior to its reorganization, settled balances between business units

immediately. Accounts payable and accrued charges at December 31, 1999, also include amounts for payments in lieu of corporate taxes and the net increase in provisions associated with the staff reduction program and the reversal of certain provisions. These increases were partially offset by the reduction in long-term accounts payable and accrued charges due to the operations of OHII currently being wound up.

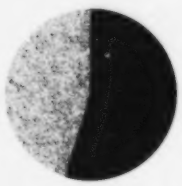
Bank Financing

On October 4, 1999, we entered into a $200 million line of credit agreement with OEFC to fund working capital requirements. This line of credit expired on March 31, 2000. During 2000, we plan to obtain a revolving standby credit facility of $500 million for a 364-day term and $250 million for a five-year term, arranged through a syndicate of financial institutions. This standby facility will be used to backstop the issuance of commercial paper and may also be used for general corporate purposes. This facility will provide for varying rates of interest based on Canadian benchmark rates, including a prime rate and a bankers' acceptance rate. In addition, we believe that covenants under the revolving credit facility will, among other things, limit our permissible total debt as a percentage of total capitalization, limit our ability to sell assets and impose a negative pledge provision, subject to customary exceptions. The indebtedness under this credit facility will rank equally with all other unsecured indebtedness.

Debt Capital Markets Borrowings

Funds generated from operations after the payment of dividends will not be sufficient to fund our repayment of the outstanding indebtedness with OEFC and to meet other liquidity and resources requirements. As a result, we intend to refinance a substantial portion of our debt that matures during 2000 through a public offering of debentures.

Capital Structure
Year ended December 31, 1999
(Canadian dollars in millions)



Debt	4,845
Equity	4,024

Market Risk

Our company faces market risks related to the restructuring of the electricity industry in Ontario and changes in interest rates.

OEB Rate Orders

Our revenues depend upon rate orders that approve revenue requirements and rates for customers of the transmission and distribution businesses. Revenue requirements and broad parameters for capital expenditures have been approved by the OEB for 2000. Rate orders beyond 2000 could be based on terms that differ significantly from the transitional rate orders for 1999 and 2000 as the restructuring of Ontario's electricity industry continues. In addition, the introduction of Open Access will result in increased competitive pressures, as both

suppliers and consumers of electricity have more freedom to determine prices. As a result, we could face some potential market risks relating to fluctuations in electricity prices in the future. We believe that these market risks will be limited.

Interest Rates

We are also exposed to risks from changing interest rates. All of the debt outstanding at December 31, 1999, is due to OEFC. It is denominated in Canadian dollars and bears interest at various rates, with a current weighted average rate of 7.7%. We intend to refinance this debt with Canadian dollar denominated, fixed-rate debt. We remain subject to interest rate related exposure as outstanding debt is refinanced with new fixed-rate debt. The effect of higher future interest rates may be partially mitigated should the OEB decide to adjust the approved revenue requirement. We do not have exposure related to fluctuations in foreign exchange rates. We may decide in the foreseeable future to issue debt in foreign currencies. It is likely that any foreign currency denominated debt would be swapped into Canadian dollars at, or about, the date of issuance to mitigate foreign exchange rate risk.

A 1% change in interest rates on the indebtedness maturing in 2000 would affect net income by $4 million in 2000. The same 1% change on the indebtedness maturing in 2001 would affect net income by an additional $5 million, for a total impact of $9 million in 2001.

Transfer of Assets

On April 1, 1999, in connection with the acquisition of our operations, we acquired and assumed assets, liabilities, rights and obligations of Ontario Hydro's electricity transmission, distribution and energy services business, except for certain transmission, distribution and other assets located on lands held for bands or bodies of Indians under the *Indian Act (Canada)*. Transfer of title to these assets did not occur because authorizations originally granted by the Canadian Federal Minister of Indian and Northern Affairs for the construction and operation of these assets could not be transferred without the consent of the Minister and the relevant Indian bands or bodies or, in several cases, because the authorizations had either expired or had never been properly issued. We manage these assets, which are currently owned by OEFC.

We have commenced negotiations with the relevant Indian bands and bodies to obtain the authorizations and consents necessary to complete the transfer of these transmission, distribution and other assets. We cannot predict the aggregate amount that we may have to pay to obtain the required authorizations and consents. We expect to pay more than $850,000 per year, which was the amount previously paid to these Indian bands and bodies by Ontario Hydro and which is the total amount of allowed costs in the transitional rate orders. If, after taking all reasonable steps, we cannot otherwise obtain the authorizations and consents from the Indian bands and bodies, OEFC will continue to hold these assets for an indefinite period of time. Alternatively, we may have to relocate these assets from the Indian lands to other locations at a cost that could be substantial, or, in a limited number of cases, to abandon a line and replace it with diesel generation facilities. In such cases we would apply to the OEB to recover these costs in future rate orders.

Environmental Compliance

We manage a number of environmental issues, including contaminated land, PCB waste in storage, PCBs in electrical equipment and pentachlorophenol-treated poles located in environmentally sensitive areas. We are required to obtain permits and approvals under applicable environmental legislation. We have a program to prevent leaks and spills as well as improve emergency response capabilities related to spills. Environmental-related operation, maintenance and administration expenses and environmental-related capital expenditures totalled $49 million in 1999 and $37 million in 1998.

Estimated expenditures for the removal and destruction of PCBs will total approximately $75 million and will be incurred during the period through to December 31, 2018. This estimate assumes that existing environmental regulations regarding PCB limits do not change and that the timetable for the phase-out of use and destruction of PCBs is not accelerated.

Estimated expenditures for land assessment and remediation are expected to total approximately $83 million over a four- to ten-year period, of which about $61 million relates to the assessment and remediation of contaminants that may have spread from transmission stations, distribution stations and operating centres to adjacent properties. This estimate assumes that only off-site contaminants will be remediated and only where they pose a risk to human health or the environment and that the further spread of off-site contamination will be prevented.

The remaining estimated expenditures related to land assessment and remediation consist of $19 million for remote generating stations and $3 million for generating station switchyards. On September 2, 1997, the Ministry of the Environment issued an administrative order against Ontario Hydro that is binding on us that has resulted in these undertakings. It is estimated that these costs will be incurred over a four- to six-year period.

The estimates for land assessment and remediation assume that the Ministry of the Environment and, in the case of the remote generating sites, the Federal Department of Indian and Northern Affairs and affected Indian bands will support our approach to assessment and remediation and that existing environmental regulations do not change.

Union Negotiations

The substantial majority of our employees are represented by either the Power Workers' Union or the Society of Energy Professionals. Existing collective agreements expire on March 31, 2000, and December 31, 2000, respectively. Negotiations with the Power Workers' Union have concluded and the collective agreement was ratified on March 31, 2000. We believe that the settlement is well balanced and reasonable. Negotiations with the Society of Energy Professionals have not commenced and therefore the impact on operations cannot be predicted at this time.

Year 2000 Compliance

Ontario Hydro initiated, and we continued, a comprehensive, three-stage program to identify and implement the changes necessary to achieve year 2000 readiness. We did not experience any significant disruption to our business operations at the turn of the century or to date. Although the change in date has occurred, it is not possible to conclude that all aspects of the year 2000 issue that may affect us, including those related to customers, suppliers or other third parties, have been fully resolved.

We spent a total of approximately $38 million addressing year 2000 issues, including $7 million in 1999, $29 million in 1998 and $2 million in 1997. These expenditures include the costs of remedying systems and hiring outside consulting firms. Expenditures to the end of 1999 represent operation, maintenance and administration costs, except for approximately $22 million identified as capital expenditures in 1998.

"Residential customers will have opportunities in the competitive market ranging from purchasing electricity only to buying bundled packages of products and services that fit their lifestyle needs for convenience. Onsource™, our residential e-utility, will be at the forefront of providing energy and related products and services such as telephone and cable in the way that the customer wants – at the best price, on one bill, delivered and paid for electronically."

Mike Miller
President and Chief Executive Officer
Ontario Hydro Energy Inc.

"As a new company building on over 90 years of experience, forging a new identity is a primary facilitator of change. Our brand strategy research of successful companies in the industry confirmed how the attributes of Hydro One – reliability, dependability, sound financial management, accountability, an engaged and empowered workforce, management strength and community involvement – will all add significant value to the enterprise above and beyond the tangible assets."

Helen Reeves
Vice President, Corporate and Public Affairs
Hydro One Networks Inc.

Outlook

The process of restructuring Ontario's electricity industry initiated by the Province will result in the wholesale and retail electricity markets becoming open to competition. Although the effect of final market rules and regulations cannot be predicted, our objective is to continue to be Ontario's leading supplier of electricity transmission, distribution and energy services. We will continue to improve overall operational efficiency, in part enabled by our staff reduction program, and will continue to participate in the development of the new regulatory and market framework for Ontario's electricity industry. We will also take advantage of our core strengths – our skilled workforce, rights of way and financial strength – to pursue selected growth opportunities.

Our most immediate growth opportunity lies within the pending rationalization of Ontario's fragmented electricity distribution infrastructure. Activities underway include acquiring, or entering into strategic relationships with, municipal electricity utilities in Ontario. We are well positioned to make such investments because of our Ontario base, distribution expertise and support infrastructure. Other growth opportunities include investing in non-electricity related network infrastructure assets, expanding transmission interconnection capabilities, providing services related to transmission, distribution and eventually other infrastructure assets, and participating in competitive retailing and the provision of a broad range of energy-related services.

Our financial position is strong. The strategy to improve operational efficiency and achieve satisfactory rate orders aims to provide the resources necessary to enhance the asset base, achieve environmental compliance, pursue selected growth opportunities and position our company well in the changing marketplace.

Reconciliation to U.S. GAAP

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). Net income under Canadian GAAP for 1999 was $64 million lower than would be the case under U.S. GAAP. Retained earnings under Canadian GAAP were $53 million lower at December 31, 1999, than would be the case under U.S. GAAP. See Note 20 to the Consolidated Financial Statements for a description of the principal differences between Canadian GAAP and U.S. GAAP, as they pertain to us. In addition, the Four-Year Summary of Financial and Operating Statistics on page 67 includes information presented in accordance with U.S. GAAP.

The accompanying Consolidated Financial Statements of Hydro One Inc. (Hydro One or the Company) are the responsibility of management and have been prepared in accordance with accounting principles generally accepted in Canada. Hydro One applies accounting principles appropriate to its circumstances. The significant accounting policies followed by the Company are described in the summary of significant accounting policies contained in Note 2 to the Consolidated Financial Statements. The preparation of financial statements necessarily involves the use of estimates based on management's judgement, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The Consolidated Financial Statements have been properly prepared within reasonable limits of materiality and in light of information available up to March 31, 2000.

Management maintained a system of internal controls designed to provide reasonable assurance that the assets were safeguarded and that reliable financial information was available on a timely basis. The system included formal policies and procedures and an organizational structure that provided for appropriate delegation of authority and segregation of responsibilities. An internal audit function independently evaluated the effectiveness of these internal controls on an ongoing basis and reported its findings to management and the Audit and Finance Committee of the Hydro One Board of Directors.

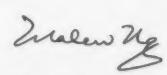
The Consolidated Financial Statements have been examined by Ernst & Young LLP, independent external auditors appointed by the Hydro One Board of Directors. The external auditors' responsibility is to express their opinion on whether the Consolidated Financial Statements are fairly presented in accordance with generally accepted accounting principles. The Auditors' Report, which appears on page 35, outlines the scope of their examination and their opinion.

On March 31, 1999, Ontario Hydro ceased operations. Ontario Hydro's management was responsible for the financial statements of Ontario Hydro for the three months ended March 31, 1999, and year ended December 31, 1998, as set forth in Ontario Hydro's Final Annual Report for the period from January 1, 1998, to March 31, 1999.

As at April 1, 1999, Hydro One became operational under the name of Ontario Hydro Services Company Inc. (OHSC) and the OHSC Board of Directors, through its Audit and Finance Committee, was responsible for ensuring that OHSC's management fulfilled its responsibilities for financial reporting and internal controls. The Audit and Finance Committee of OHSC met periodically with management, the internal auditors and the external auditors to satisfy itself that each group had properly discharged its respective responsibility and to review the Consolidated Financial Statements before recommending approval by the Board of Directors. The external auditors had direct and full access to the Audit and Finance Committee, with and without the presence of management, to discuss their audit and their findings as to the integrity of the financial reporting and the effectiveness of the system of internal controls. In May 2000, the company name changed to Hydro One Inc.

On behalf of Hydro One Inc.'s Management:

Eleanor R. Clitheroe
Chairman and Chief Executive Officer



Malen S. Ng
Executive Vice President and Chief Financial Officer

March 31, 2000

To the Directors of Hydro One Inc.:

We have audited the consolidated balance sheet of Hydro One Inc., formerly Ontario Hydro Services Company Inc., (the Company) as at December 31, 1999, and the balance sheet of the electricity transmission, distribution and energy services businesses of Ontario Hydro (the Acquired Businesses) as at December 31, 1998, the combined consolidated statements of operations, shareholder's equity and cash flows of the Company and the Acquired Businesses for the year ended December 31, 1999, the consolidated statements of operations, shareholder's equity and cash flows of the Company for the nine months ended December 31, 1999, and the statements of operations, shareholder's equity and cash flows of the Acquired Businesses for the three months ended March 31, 1999, and the year ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Canada. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1999, the financial position of the Acquired Businesses as at December 31, 1998, the combined results of operations and cash flows of the Company and the Acquired Businesses for the year ended December 31, 1999, the results of operations and cash flows of the Company for the nine months ended December 31, 1999, and the results of operations and cash flows of the Acquired Businesses for the three months ended March 31, 1999, and the year ended December 31, 1998, in accordance with accounting principles generally accepted in Canada.

Ernst & Young LLP

Ernst & Young LLP
Chartered Accountants
Toronto, Canada

March 31, 2000

(Canadian dollars in millions)	9 months ended December 31	1999 Acquired Businesses 3 months ended March 31	1999 Combined Year ended December 31	1998 Acquired Businesses Year ended December 31
Revenues				
Transmission *(Note 13)*	**932**	**305**	**1,237**	1,178
Distribution (including retail) *(Note 13)*	**1,298**	**518**	**1,816**	1,746
Other	**45**	**27**	**72**	124
	2,275	**850**	**3,125**	3,048
Costs				
Operation, maintenance and administration *(Note 4)*	**669**	**194**	**863**	723
Purchased power *(Note 13)*	**662**	**277**	**939**	1,165
Depreciation and amortization *(Note 5)*	**267**	**75**	**342**	300
Transitional cost adjustment *(Note 6)*	**–**	**55**	**55**	–
Provincial debt guarantee fee *(Note 13)*	**–**	**8**	**8**	31
Deferred pension asset *(Note 15)*	**–**	**–**	**–**	(204)
	1,598	**609**	**2,207**	2,015
Other income				
Gain on sale of investment *(Note 7)*	**32**	**–**	**32**	–
Income before financing charges and provision for payments in lieu of corporate income taxes	**709**	**241**	**950**	1,033
Financing charges *(Notes 8 and 13)*	**250**	**131**	**381**	559
Income before provision for payments in lieu of corporate income taxes	**459**	**110**	**569**	474
Provision for payments in lieu of corporate income taxes *(Notes 9 and 13)*	**194**	**–**	**194**	–
Net income	**265**	**110**	**375**	474

See accompanying notes to Consolidated Financial Statements (including Note 2 – Significant Accounting Policies, which describes the basis of presentation).

December 31 (Canadian dollars in millions)	1999	1998 Acquired Businesses
Assets		
Current assets		
Cash and temporary investments	468	44
Accounts receivable (net of allowance for doubtful accounts – $9 million, 1998 – $9 million)	536	398
Materials and supplies	81	65
	1,085	507
Fixed assets *(Note 10)*		
Fixed assets in service	11,907	12,044
Less: accumulated depreciation	3,848	3,828
	8,059	8,216
Construction in progress	300	167
	8,359	8,383
Other long-term assets		
Other post-retirement and post-employment benefits asset *(Note 15)*	377	–
Long-term accounts receivable and other assets	28	69
Deferred debt costs	–	252
Deferred pension asset *(Note 15)*	241	224
	646	545
Total assets	10,090	9,435
Liabilities		
Current liabilities		
Bank indebtedness	–	5
Accounts payable and accrued charges	403	260
Short-term notes payable *(Note 11)*	–	563
Accrued interest	72	137
Long-term debt payable within one year *(Note 11)*	1,399	491
	1,874	1,456
Long-term debt *(Note 11)*	3,446	5,128
Other long-term liabilities		
Other post-retirement and post-employment benefits *(Note 15)*	453	305
Long-term accounts payable and accrued charges	52	115
Regulatory liability *(Note 15)*	241	–
	746	420
Total liabilities	6,066	7,004
Contingencies and commitments *(Notes 16 and 17)*		
Shareholder's equity		
Shares to be issued *(Notes 3 and 18)*		
Preferred shares	323	–
Common shares	3,436	–
Retained earnings	94	2,431
Dividends to be paid *(Note 18)*	171	–
Total shareholder's equity	4,024	2,431
Total liabilities and shareholder's equity	10,090	9,435

See accompanying notes to Consolidated Financial Statements (including Note 2 – Significant Accounting Policies, which describes the basis of presentation).

On behalf of the Board:

Sir Graham Day
Chairman of the Board of Directors

Eleanor R. Clitheroe
President and Chief Executive Officer

December 31, 1998 (Canadian dollars in millions)

Excess of assets over liabilities of the Acquired Businesses, January 1	2,065
Net income, for the year ended December 31	474
Less: Adjustment for other post-retirement and post-employment benefits *(Note 15)*	(108)
Excess of assets over liabilities of the Acquired Businesses, December 31	2,431

December 31, 1999 (Canadian dollars in millions)

Excess of assets over liabilities of the Acquired Businesses, January 1	**2,431**
Net income, for the three months ended March 31	**110**
Net refunds on annexation by municipalities *(Note 10)*	**(25)**
Net excess of assets over liabilities of the Acquired Businesses, March 31	**2,516**
Capitalization of Hydro One Inc., April 1	
Shares to be issued *(Notes 3 and 18)*	
Preferred shares	**323**
Common shares	**3,436**
	3,759
Net income, for the nine months ended December 31	**265**
Less: Dividends to be paid *(Note 18)*	**(171)**
	94
	3,853
Dividends to be paid *(Note 18)*	**171**
Total shareholder's equity	**4,024**

See accompanying notes to Consolidated Financial Statements (including Note 2 – Significant Accounting Policies, which describes the basis of presentation).

(Canadian dollars in millions)	9 months ended December 31	1999 Acquired Businesses 3 months ended March 31	1999 Combined Year ended December 31	1998 Acquired Businesses Year ended December 31
Operating activities				
Net income	**265**	**110**	**375**	474
Adjustments for non-cash items:				
Depreciation and amortization (net of removal costs) *(Note 5)*	**253**	**71**	**324**	276
Transitional cost adjustment	**–**	**55**	**55**	–
Deferred pension asset	**–**	**–**	**–**	(204)
Gain on sale of investment	**(32)**	**–**	**(32)**	–
Other	**(18)**	**9**	**(9)**	34
	468	**245**	**713**	580
Changes in non-cash balances related to operations *(Note 14)*	**43**	**38**	**81**	(60)
Cash provided by operations	**511**	**283**	**794**	520
Financing activities				
Net change in debt for long-term financing	**–**	**(168)**	**(168)**	(98)
Investing activities				
Fixed assets	**(389)**	**(94)**	**(483)**	(383)
Proceeds on disposal of fixed assets and investments	**245**	**–**	**245**	–
Other assets	**49**	**(8)**	**41**	–
Cash used in investing activities	**(95)**	**(102)**	**(197)**	(383)
Net change in cash and cash equivalents	**416**	**13**	**429**	39
Cash and cash equivalents at beginning of period	**52**	**39**	**39**	–
Cash and cash equivalents at end of period *(Note 14)*	**468**	**52**	**468**	39

See accompanying notes to Consolidated Financial Statements (including Note 2 – Significant Accounting Policies, which describes the basis of presentation).

Note 1

Incorporation and Commencement of Operations

Hydro One Inc. (Hydro One or the Company) was incorporated on December 1, 1998, under the *Business Corporations Act (Ontario)* and issued 10 common shares for nominal consideration, and is wholly owned by the Province of Ontario (the Province). As part of the reorganization of Ontario Hydro under the *Electricity Act, 1998*, and the related restructuring of the electricity industry in Ontario, Hydro One acquired and assumed certain assets, liabilities, rights and obligations of the electricity transmission, distribution and energy services businesses of Ontario Hydro (the Acquired Businesses) on April 1, 1999, and commenced operations on that date. In exchange, the Company issued debt and an additional promissory note (see Note 3). Hydro One thereby became an electricity transmission, distribution and energy services company operating under the authority of the *Electricity Act, 1998*.

The principal business of Hydro One is the transmission and distribution of electricity to customers within Ontario and is regulated by the Ontario Energy Board (OEB).

Note 2

Significant Accounting Policies

Basis of Consolidation

The Consolidated Financial Statements include the accounts of the Company and its wholly owned subsidiaries: Hydro One Networks Inc., Ontario Hydro Energy Inc., Hydro One Remote Communities Inc., Hydro One Markets Inc., Hydro One Telecom Inc., Ontario Hydro Delivery Services Company Inc. and Ontario Hydro International Inc.

Basis of Accounting

These Consolidated Financial Statements are prepared in accordance with accounting principles generally accepted in Canada (Canadian GAAP) and conform with accounting principles generally accepted in the United States (U.S. GAAP), except as disclosed in Note 20.

The financial position, results of operations and cash flows presented in these Consolidated Financial Statements as at dates and for the period prior to April 1, 1999, represent all assets, liabilities, rights and obligations of Ontario Hydro pertaining to the Acquired Businesses now conducted by Hydro One. These amounts have been recorded in Hydro One's Consolidated Financial Statements on the same basis and in the same periods as originally recorded by Ontario Hydro. These financial statements, prior to April 1, 1999, have been prepared primarily through specific identification of assets, liabilities (other than debt), revenues and expenses relating to such businesses, but also through an allocation of certain common financial statement accounts and items of Ontario Hydro. In particular, a portion of Ontario Hydro's revenues and debt, and corresponding portion of related interest and other financial expenses, have been allocated to Hydro One.

Rate-Setting

The *Ontario Energy Board Act, 1998*, gave the OEB increased powers and responsibilities to regulate the electricity industry. These powers and responsibilities include the power to approve or fix rates for the transmission and distribution of electricity, the power to provide continued rate protection for rural and remote electricity consumers, and the responsibility for ensuring that distribution companies fulfill obligations to connect and service customers. In its capacity to approve or fix rates, the OEB has the authority to specify regulatory treatments that may result in accounting treatments that differ from Canadian GAAP for enterprises operating in a non-rate-regulated environment.

Prior to April 1, 1999, Ontario Hydro was governed by the *Power Corporation Act*, which provided it with broad powers to generate, supply and deliver electricity throughout Ontario. Under the *Power Corporation Act*, Ontario Hydro's Board of Directors was responsible for setting wholesale and retail electricity rates charged to Ontario Hydro's customers and regulating rates that could be charged by municipal electricity utilities to their retail customers and had the authority, for rate-setting purposes, to specify regulatory treatments that may result in accounting treatments that differ from Canadian GAAP for enterprises operating in a non-rate-regulated environment.

The OEB issued and the Minister of Energy, Science and Technology approved, transitional rate orders for Hydro One effective April 1, 1999. As a result of these rate orders, the following accounting treatments, which differ from Canadian GAAP for enterprises operating in a non-rate-regulated environment, apply to the regulated businesses of the Company:

I. Pension costs are recorded in results of operations when employer contributions are paid to the pension fund; and

II. Payments in lieu of corporate income taxes are recorded in results of operations on the taxes payable basis.

Under Canadian GAAP for enterprises operating in a non-rate-regulated environment, pension costs would be recorded in results of operations on an accrual basis and payments in lieu of corporate income taxes would be recorded in results of operations using the income tax allocation method.

The OEB has allowed for the recovery of other post-retirement and post-employment benefits, including the recovery of past service cost, in the revenue requirement on an accrual basis, which gives rise to a regulatory asset.

In addition, the following accounting treatments were approved by Ontario Hydro's Board of Directors in its rate-setting capacity and apply to amounts recorded prior to April 1, 1999:

I. Discounts and premiums arising from the acquisition of debt prior to maturity were deferred; and

II. Foreign exchange gains and losses on U.S. dollar-denominated short-term financing used to replace U.S. dollar-denominated long-term debt redeemed prior to maturity were deferred.

Under Canadian GAAP for enterprises operating in a non-rate-regulated environment, these amounts would have been included as gains or losses of the period in which they arose.

Revenue Recognition and Allocation

The transitional rate orders issued by the OEB effective April 1, 1999, approved the transmission and distribution revenue requirements for 1999 and 2000, which are designed to permit these regulated businesses to recover their allowed costs and earn a forecasted annual rate of return of 9.35% for 1999 on average common equity during the year deemed, for regulatory purposes, to be allocated to such businesses. For 2000, the OEB adjusted the rate of return to 9.88% to reflect higher forecasted interest rates for that year. Although Hydro One did not commence operations as a stand-alone enterprise separate from Ontario Hydro until April 1, 1999, the transitional rate orders formed the basis of revenue recognition for the three months ended March 31, 1999, consistent with a draft revenue allocation agreement to be entered into among the successor corporations.

Wholesale customers in Ontario have traditionally been billed on a bundled basis, under which the billed amount aggregated the generation and transmission charges for the provision of electricity. Retail rates are also essentially bundled and set similarly to wholesale rates. Until the creation of competitive wholesale and retail electricity markets (Open Access), electricity customers will continue to pay bundled rates for electricity. Revenues are being collected, pooled and allocated to the successor corporations of Ontario Hydro consistent with a draft revenue allocation agreement to be entered into among such corporations. This draft

agreement incorporates the revenue requirements approved in the transitional rate orders issued by the OEB. Prior to 1999, transmission revenue was allocated based on an internal mechanism used by Ontario Hydro. The annual transmission revenue requirement was determined primarily based on an estimate of the planned cost components and a specified rate of return on assets.

Distribution (including retail) revenue represents actual, rather than allocated, revenues attributable to the sale and delivery of electricity, and is recognized as power is delivered to customers. Because customer meters are generally read on a quarterly basis, it is necessary to estimate the monthly revenue for the period based on wholesale power purchases. These estimates are reconciled to actual customer consumption on a regular basis.

Distribution (including retail) revenue also includes an amount relating to rate protection for rural residential customers. The rural rate protection program that had been in effect since 1982 was repealed on April 1, 1999 and replaced with a comparable regime for rural rate protection under the *Ontario Energy Board Act, 1998*. Under this Act, in approving electricity rates for a distributor that delivers electricity to rural residential consumers, the OEB is required to provide rate protection for prescribed classes of consumers by reducing the electricity rates that would otherwise apply so that the weighted average rural bill does not exceed the weighted average municipal bill by more than 15%.

Corporate Income and Capital Taxes

Prior to April 1, 1999, the Company's businesses were effectively carried out as business units of Ontario Hydro, which were exempt from corporate income and capital taxes.

Under the *Electricity Act, 1998*, Hydro One is required to make payments in lieu of corporate taxes to Ontario Electricity Financial Corporation (OEFC), commencing April 1, 1999. These payments are calculated in accordance with the rules for computing income and taxable capital and other relevant amounts contained in the *Income Tax Act (Canada)* and the *Corporations Tax Act (Ontario)* as modified by the *Electricity Act, 1998*, and related regulations.

The Company provides for payments in lieu of corporate income taxes relating to its regulated businesses using the taxes payable method as directed by the OEB. Under the taxes payable method, no provisions are made for future income taxes as a result of differences in timing between the treatment of various income and expenditure items for income tax and accounting purposes. When unrecorded future income taxes become payable, it is expected that they will be included in the rates approved by the OEB and recovered from the customers of Hydro One at that time.

Materials and Supplies

Materials and supplies represent inventories of spare parts and supplies acquired for internal construction or consumption. These assets are carried at the lower of average cost and replacement cost.

Fixed Assets

Fixed assets are capitalized at cost, which comprises materials, labour, engineering costs, overheads, depreciation on service equipment and interest applicable to capital construction activities.

Fixed assets in service consist of transmission and transformation, distribution (including retail), communication, and administration and service assets. These asset categories are described below:

Transmission

Transmission assets include assets used for the transmission of high-voltage electricity, such as transmission lines, support structures, foundations, insulators, connecting hardware and grounding systems, and assets used to step up the voltage of electricity from generating stations for transmission and to step down voltages for distribution, such as transformers, circuit breakers and switches.

Distribution (including retail)

Distribution (including retail) assets comprise assets related to the distribution of low-voltage electricity, including lines, poles, switches, transformers, protective devices and metering systems. Also included in this class are street lighting and water heater assets.

Communication

Communication assets include the microwave radio system, optical ground wire, towers, telephone equipment and associated buildings.

Administration and Service

Administration and service assets include administrative buildings, major computer systems, personal computers, transport and work equipment, tools and vehicles.

Construction in Progress

Construction in progress comprises fixed assets under construction, future use assets and development costs associated with specific facilities.

Interest is capitalized on fixed assets under construction at rates that approximate the average cost of all long-term funds borrowed (1999 – 7.9%, 1998 – 9.4%).

Impairment of Fixed Assets

In the event that facts and circumstances indicate that a fixed asset may be impaired, an evaluation of recoverability is performed. For purposes of such an evaluation, the estimated future undiscounted cash flows associated with the fixed asset are compared to the asset's carrying amount to determine if a write-down is required.

Depreciation

The capital costs of fixed assets are depreciated on a straight-line basis, except for transport and work equipment and personal computers, which are depreciated on a declining balance basis.

Depreciation rates for the various classes of assets are based on their estimated service lives. The estimated service lives of assets in major classes are:

	Estimated service lives	
	Range	Average
Transmission	**12–100 years**	**51**
Distribution (including retail)	**15–55 years**	**41**
Communication	**7–40 years**	**22**
Administration and service	**5–50 years**	**38**

Administration offices and buildings are depreciated over 50 years. Service equipment and leasehold improvements are depreciated over a period ranging between five and ten years. The costs of normal fixed asset retirements are charged to accumulated depreciation, with no gain or loss reflected in operations. Gains and losses on sales of fixed assets and losses on premature retirements are charged to results of operations as adjustments to depreciation expense. Depreciation expense also includes the costs of removing fixed assets.

The estimated service lives of fixed assets are subject to periodic review. Any changes arising out of such a review are implemented on a remaining service life basis from the year the changes can first be reflected in rates.

Allocation of Debt and Financing Charges

For the purpose of preparing historical financial statements, the debt, related derivatives and debt costs of Ontario Hydro were notionally allocated to Hydro One and the other successor corporations for the period prior to April 1, 1999. The debt of Ontario Hydro, and related derivative financial instruments used to hedge interest and foreign exchange rate risks associated with such debt, were issued or incurred for general purposes and were not specifically identified with particular assets or businesses of Hydro One. In addition, none of Ontario Hydro's debt and related derivatives has been assumed by Hydro One as part of the reorganization of Ontario Hydro.

Ontario Hydro's debt was notionally allocated to Hydro One based on a formula: allocated debt is equal to the total assets of each of Hydro One's businesses, less the sum of liabilities (other than debt) and excess of assets over liabilities of such businesses.

Financing charges (consisting of interest, realized and unrealized foreign exchange gains and losses, and realized and unrealized foreign exchange and interest rate hedging gains and losses) were allocated to Hydro One based on its proportion of allocated Ontario Hydro debt.

Foreign Currency Translation

Current monetary assets and liabilities in foreign currencies are translated to Canadian currency at year-end rates of exchange and the resulting exchange gains or losses are credited or charged to results of operations.

The following accounting treatments applied to the Ontario Hydro debt notionally allocated to Hydro One:

i. **Long-term debt payable in foreign currencies was translated to Canadian currency at year-end rates of exchange and resulting unrealized exchange gains or losses were deferred and amortized on an annuity basis over the remaining life of the related debt;**

ii. **Foreign exchange gains or losses on hedges of long-term debt payable in foreign currencies were deferred and amortized to results of operations on an annuity basis in the periods the hedges provided benefit; and**

iii. **Foreign exchange gains or losses on early redemption of long-term debt, including subsequent gains or losses on short-term replacement financing, were deferred and included in deferred debt costs if the exposure in the foreign currency of the redeemed debt was continued by refinancing the redeemed debt in the same currency. These deferred gains or losses were amortized on an annuity basis over the period to the original maturity date of the redeemed debt. If the foreign currency exposure was reduced as a result of the early redemption of debt, the resulting foreign exchange gains or losses related to the redeemed debt were credited or charged to results of operations.**

Deferred Debt Costs

The following accounting treatments applied to the Ontario Hydro debt notionally allocated to Hydro One:

i. **Discounts or premiums arising from the issuance of debt were amortized over the period to maturity of the debt on an annuity basis when the term of the debt exceeded one year and on a straight-line basis when the term was one year or less;**

ii. **Discounts or premiums on debt acquired prior to the date of maturity were amortized on an annuity basis over the period from the acquisition date to the original maturity date of the debt; and**

iii. **Discounts or premiums on foreign currency hedges were credited or charged to results of operations on an annuity basis over the terms of the individual hedges.**

Pension Plan

Hydro One established its own pension plan on January 1, 2000. Until that date, employees and pensioners continued as members of the Ontario Electricity Financial Corporation Pension Plan (OEFC Pension Plan), formerly the Ontario Hydro Pension and Insurance Plan. The transfer of assets and liabilities from the OEFC Pension Plan to the successor corporation pension plans, including the Hydro One pension plan, is expected in mid-2000 and is subject to regulatory approval. The information presented in these financial statements for the period commencing on April 1, 1999, has been derived from the OEFC Pension Plan and is based upon Hydro One's proportionate share of the OEFC Pension Plan's assets and liabilities. For the period prior to April 1999, such information is based upon Hydro One's proportionate share of Ontario Hydro's payroll.

The pension plan is a contributory, defined benefit plan covering all regular employees of Hydro One. Pension costs are recorded in results of operations when employer contributions are paid to the pension fund in accordance with the transitional rate orders approved by the OEB. The present value of the accrued pension benefit obligation is actuarially determined using the projected benefit method pro-rated on service and based on assumptions that reflect management's best estimates. Pension plan assets are valued using current fair values.

Other Post-Retirement and Post-Employment Benefits

In addition to pension benefits, Hydro One provides other post-retirement benefits (OPRB) such as group life insurance and health-care benefits and other post-employment benefits (OPEB) such as workers' compensation benefits and long-term disability benefits to qualifying employees during extended absences from work due to sickness or injury.

OPRB and OPEB costs are recorded on an accrual basis. Costs are actuarially determined using the projected benefit method and based on assumptions that reflect management's best estimates. OPRB costs are pro-rated on service. OPRB past service costs and actuarial gains and losses are amortized over the average remaining service period of active employees. OPEB costs are accrued when the event occurs that gives rise to the obligation on the part of the Company. OPEB past service costs and actuarial gains and losses are recognized when they occur.

On December 31, 1998, the rate used to discount future benefits was changed from a long-term average rate to a current market settlement rate and the resulting increase in OPRB and OPEB liabilities of $108 million was charged to shareholder's equity.

OPRB and OPEB costs have been included in rates on a basis consistent with the related accounting treatment.

Applications Software and Year 2000 Expenditures

Hydro One capitalizes major applications software acquisition costs when future benefit is reasonably assured. Expenditures incurred to address the year 2000 issue are charged to results of operations as incurred, unless existing assets are replaced with new versions or with completely new systems. In such cases, the year 2000 expenditures are capitalized consistent with the accounting for any acquisition project.

Use of Estimates

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses for the year. Actual results could differ from the estimates.

Note 3

Reorganization of Ontario Hydro

On November 7, 1998, the *Electricity Act, 1998*, was enacted by the Province. This Act reorganized Ontario Hydro into separate successor corporations, which commenced operations on April 1, 1999. In connection with the reorganization of Ontario Hydro, four successor entities were created in addition to Hydro One Inc. Ontario Power Generation Inc. (together with its subsidiaries, OPG) is the successor corporation to Ontario Hydro's electricity generation business. The Independent Electricity Market Operator (IMO) is responsible for directing the operations and reviewing the reliability of the Ontario electricity market, and the Electrical Safety Authority (ESA) has the responsibility for electrical equipment and wiring installation inspection functions. Ontario Hydro has continued as OEFC, responsible for managing and retiring Ontario Hydro's outstanding debt and other obligations.

OEFC has stranded debt. Stranded debt is defined as debt that the successor corporations could not service as commercial entities in a competitive market. The Province has stated that it will dedicate certain of its revenue streams from the restructured electricity industry (e.g., payments in lieu of corporate taxes made by Hydro One, OPG and local distribution utilities) to service stranded debt. The Province anticipates that these dedicated revenue streams will service the majority of the stranded debt, with the balance serviced through a competition transition charge to be reflected in customers' electricity bills. The precise amount of any competition transition charge will reflect actual price and cost performance in the new competitive market. Hydro One has no obligation to pay, does not guarantee, and is not otherwise responsible for any stranded debt.

In exchange for substantially all of the assets, liabilities, rights and obligations of the electricity transmission, distribution and energy services businesses of Ontario Hydro with a net value of $8.6 billion, the Company issued to OEFC notes payable in an aggregate principal amount of $4.85 billion, together with an additional promissory note in the principal amount of $3.76 billion, which will be assumed by the Province in connection with the issuance of equity upon the completion of the transaction (see Notes 11 and 18).

The capitalized value of the Company as at April 1, 1999 was determined as follows:

(Canadian dollars in millions)

Excess of assets over liabilities of the Acquired Businesses as at March 31, 1999	2,516
Adjustments:	
Elimination of allocated long-term debt from Ontario Hydro	5,382
Elimination of allocated short-term notes from Ontario Hydro	533
Elimination of allocated accrued interest	143
Elimination of allocated deferred debt costs	(228)
Debt issued effective as of April 1, 1999	(4,845)
	985
Other post-employment benefit asset *(Note 15)*	419
Adjustment to deferred pension asset *(Note 15)*	164
Regulatory liability *(Note 15)*	(386)
Other net adjustments	61
	3,759
Represented by:	
Shares to be issued *(Note 18)*	3,759

The purchase of the Acquired Businesses from the related party, OEFC, was recorded at the exchange amount of $8.6 billion, which equals the book values of the assets acquired and liabilities assumed on April 1, 1999, and, in the current regulatory environment, approximates their fair value.

Subsequent to additional verification of account balances by Hydro One and OEFC, the actual net amount of assets and liabilities acquired was less than estimates by $122 million. This excess of equity and liabilities over assets has been recorded as an account receivable, pending the outcome of negotiations related to the deferred pension asset and contributions in aid of construction.

The financial statements include a deferred pension asset and an offsetting regulatory liability. The Company's interpretation of the transitional rate orders issued by the OEB for Hydro One effective April 1, 1999, is that the revenue requirement is based on pension costs being recorded in operations when employer contributions are paid to the pension fund. As a rate-regulated entity, Hydro One must account for pension costs on this basis for the regulated portions of the business. The OEB has indicated that the rate treatment of pension costs could be re-examined at a future rate hearing. In the event that the OEB determines that the pension costs should be included in the revenue requirement on an accrual basis, Hydro One would not be required to record a regulatory liability.

In addition, contributions in aid of construction are recorded as a nil amount, on a net basis, within fixed assets (see Note 10). On January 18, 2000, the OEB decided that contributions in aid of construction collected by municipal electricity utilities prior to January 1, 2000, in accordance with the previous regulatory environment, can continue to be recovered through the revenue requirement. If the OEB confirms that Hydro One can adopt the same regulatory accounting treatment related to its distribution assets, and this overall industry treatment is acceptable to the Province, then Hydro One would be required to record amounts for contributions in aid of construction. Rate hearings planned for municipal electricity utilities and Hydro One's regulated distribution business during the year 2000 will provide the basis for resolution of this issue.

It has been proposed that the $122 million receivable be adjusted through shareholder's equity. If it is determined that the regulatory liability should not be recorded or that amounts for contributions in aid of construction should be recorded, Hydro One anticipates that a post-acquisition adjustment would be made to increase debt and shareholder's equity in a manner consistent with the original capital structure. At this time, the outcome of these negotiations, and the impact on debt, equity or other net assets, cannot be determined.

Note 4

Operation, Maintenance and Administration

In November 1999, Hydro One approved a staff reduction program intended to reduce cost levels in 2000 and subsequent years. The Company plans to achieve this reduction through a voluntary retirement program, supplemented by targeted voluntary buyouts and involuntary severance using mechanisms available within existing collective agreements. Most of the costs for the staff reduction program will be funded from Hydro One's pension plan surplus. The funding impact on the pension surplus is expected to range between $240 million and $270 million. Hydro One has also recognized a $60 million charge to 1999 results of operations related to cash incentives and supplementary pension benefits that cannot be charged to the pension surplus. This amount also includes a small provision for the estimated cost of limited targeted buyouts and involuntary severance.

In addition, at year end Hydro One re-evaluated the need for some provisions previously recognized by Ontario Hydro and assumed by the Company on April 1, 1999. These provisions related to involuntary staff reduction costs and some future real estate costs. A provision for involuntary staff reductions totalling $21 million was recognized by Ontario Hydro in 1997. The remaining balance of $14 million will not be used and has been reversed as a credit to results of operations in 1999. The real estate provisions were recorded by Ontario Hydro in 1993 and were for estimated future post-occupancy costs, and for post-occupancy costs related to several other surplus real estate properties that were previously expected to be sold with no gain. Due to a change in market and other business conditions, some of these properties will now be retained and those properties to be sold are now likely to result in a gain. A total of $22 million related to real estate costs accrued by Ontario Hydro in 1993 was reversed as a credit to 1999 results of operations.

Note 5

Depreciation and Amortization

(Canadian dollars in millions)	9 months ended December 31	3 months ended March 31	1999 Combined Year ended December 31	1998 Acquired Businesses Year ended December 31
		Acquired Businesses		
Depreciation of fixed assets in service	201	71	272	276
Fixed asset removal costs	14	4	18	24
Amortization of regulatory assets	52	–	52	–
	267	75	342	300

Note 6

Transitional Cost Adjustment

The transitional cost adjustment represents the difference between allowed costs specified in the OEB transitional rate orders, and costs incurred by Ontario Hydro that were allowed under the *Power Corporation Act*. Costs included in Hydro One's rate base are higher due to payments in lieu of corporate taxes and an amount for amortization relating to the recovery of OPRB and OPEB costs. These additional costs are partially offset by reduced financing charges resulting from lower debt balances that reflect the new capital structure of the Company and lower interest rates as well as the elimination of the provincial debt guarantee fee levied by the Province. The transitional cost adjustment constitutes a one-time charge that will not recur in future periods.

The following summarizes the components of the transitional cost adjustment for the first three months of 1999:

3 months ended March 31, 1999 (Canadian dollars in millions)	Acquired Businesses
Depreciation and amortization	10
Payments in lieu of capital tax	6
Payments in lieu of corporate income taxes	87
Provincial debt guarantee fee	(8)
Financing charges	(40)
	55

Note 7

Ontario Hydro International Inc.

On September 15, 1999, Hydro One's subsidiary, Ontario Hydro International Inc., sold its 25% equity interest in Ontario Quinta A.V.V. (Ontario Quinta), resulting in a gain before income taxes of $32 million. At the time of the sale, Ontario Quinta held a 60% interest in Luz del Sur S.A.A., an electricity distribution company serving southern Lima, Peru, and a 64% interest in Tecsur S.A.A., a utility maintenance and construction company also operating in Peru.

Prior to the sale, the results of operations, and the assets and liabilities of Ontario Quinta had been proportionately consolidated within Hydro One's financial statements.

The following summarizes the effects on the results of operations and financial position of using proportionate consolidation to account for the Ontario Quinta investment for the period prior to the sale. The effect on net income is equal to that which would have been obtained under the equity method (see Note 20).

Statements of Operation

			1999	1998
		Acquired Businesses	Combined	Acquired Businesses
(Canadian dollars in millions)	9 months ended December 31	3 months ended March 31	Year ended December 31	Year ended December 31
Revenues	**43**	**26**	**69**	116
Operation, maintenance and administration	**15**	**9**	**24**	39
Purchased power	**24**	**13**	**37**	65
Depreciation and amortization	**2**	**2**	**4**	6
Financing charges	**–**	**–**	**–**	(3)
Net income	**2**	**2**	**4**	9

Balance Sheets

December 31 (Canadian dollars in millions)	1999	1998
		Acquired Businesses
Fixed assets (net)	**–**	113
Current assets	**–**	31
Other assets	**–**	12
Accounts payable	**–**	(30)
Long-term accounts payable	**–**	(49)
Investment account under the equity method of accounting	**–**	77

Note 8

Financing Charges

(Canadian dollars in millions)	9 months ended December 31	Acquired Businesses 3 months ended March 31	1999 Combined Year ended December 31	1998 Acquired Businesses Year ended December 31
Interest on short-term notes payable	–	–	–	30
Interest on long-term debt payable	277	134	411	539
Foreign exchange losses	–	–	–	6
Less: Interest charged to construction in progress	(15)	(3)	(18)	(10)
Less: Interest earned on investments	(12)	–	(12)	(6)
	250	131	381	559

Note 9

Corporate Income Taxes

Hydro One was not subject to payments in lieu of corporate income taxes (PILs) prior to April 1, 1999.

A reconciliation between the statutory and effective tax rate is provided as follows:

Year ended December 31 (Canadian dollars in millions)	1999
Income before provision for PILs	569
PILs included in the transitional cost adjustment *(Note 6)*	87
Less: Income before provision for PILs for the period January 1 to March 31, 1999	(197)
Adjusted income before provision for PILs	459
Federal and Ontario statutory income tax rate	44.62%
Statutory income tax rates applied to accounting income	205
Increase (decrease) in income taxes resulting from:	
The application of the income taxes payable method to the regulated businesses:	
Net temporary differences:	
Capital cost allowance in excess of depreciation and amortization	(50)
OPRB and OPEB expense in excess of OPRB and OPEB liability payments	3
Staff reduction charge in excess of cash payments	27
Interest capitalized for accounting purposes, but deducted for tax purposes	(7)
Net temporary differences	(27)
Permanent differences:	
Large corporations tax	11
Other items	5
Provision for PILs	194
Effective income tax rate	42.27%

Future income taxes relating to the regulated businesses have not been recorded in the accounts as they are expected to be recovered through future revenues. As at December 31, 1999, future income tax liabilities of $27 million have not been recorded.

Note 10

Fixed Assets

December 31, 1999 (Canadian dollars in millions)	Fixed assets in service	Accumulated depreciation	Construction in progress	Total
Transmission	**7,629**	**2,287**	**248**	**5,590**
Distribution (including retail)	**3,711**	**1,310**	**47**	**2,448**
Communication	**322**	**178**	**1**	**145**
Administration and service	**245**	**73**	**4**	**176**
	11,907	**3,848**	**300**	**8,359**

Acquired Businesses December 31, 1998 (Canadian dollars in millions)	Fixed assets in service	Accumulated depreciation	Construction in progress	Total
Transmission	7,536	2,205	91	5,422
Distribution (including retail)	3,889	1,355	56	2,590
Communication	322	178	19	163
Administration and service	297	90	1	208
	12,044	3,828	167	8,383

Fixed assets include contributions in aid of construction of $50 million for transmission (1998 – $50 million) and $194 million for distribution (including retail) (1998 – $196 million). Contributions in aid of construction represents fixed assets owned by the Company. Since Hydro One did not pay for these assets, they have been recorded in the fixed asset accounts as nil, on a net basis.

Interest capitalized on fixed assets under construction was $18 million in 1999 (1998 – $10 million).

Pursuant to certain provisions of the *Power Corporation Act*, some municipalities in Ontario were permitted to expand the service territories of their respective municipal electricity utilities to include areas that were served by Ontario Hydro. These expansions involved the transfer of distribution assets, liabilities and customers from Ontario Hydro to the relevant municipal electricity utility at a prescribed price. The price payable for the transferred assets was prescribed by the *Power Corporation Act* as being equal to the original cost of the assets less the sum of the accumulated net retail equity and the accumulated depreciation associated with those assets as recorded in Ontario Hydro's books.

During 1998, $34 million of distribution assets were transferred to municipal electricity utilities. Approximately $75 million of distribution assets were transferred to municipal electricity utilities during 1999. The ability of municipalities to exercise this statutory expansion right ceased as of April 1, 1999.

Note 11

Debt

December 31 (Canadian dollars in millions)	1999	1998 Acquired Businesses
Short-term notes payable	**–**	563
Long-term debt payable within one year	**1,399**	491
Long-term debt	**3,446**	5,128
	4,845	6,182

Debt as at December 31, 1999, represents various notes payable to OEFC. All notes are denominated in Canadian dollars. These notes are summarized by the number of years to maturity in the following table:

Years to maturity	Principal outstanding (Canadian dollars in millions)	Weighted average interest rate (percent)
1 year	1,399	5.8
2 years	474	7.2
3 years	443	11.0
4 years	651	7.2
5 years	682	6.8
	3,649	7.1
6–10 years	1,196	9.5
	4,845	7.7

Debt as at December 31, 1998 represents a notional allocation of Ontario Hydro's debt to Hydro One based on a formula: allocated debt is equal to the total assets of each of Hydro One's businesses, less the sum of liabilities (other than debt) and excess of assets over liabilities of such businesses. The weighted average interest rate on the debt allocated to Hydro One, after giving effect to Ontario Hydro's interest rate risk management activities, was 9.0% for 1998 (see Note 2).

Note 12

Fair Value of Financial Instruments and Credit Risk

Fair Value

The following table presents the carrying amounts and fair values of financial instruments:

December 31 (Canadian dollars in millions)	1999	
	Carrying value	Fair value
Long-term debt	4,845	5,175

The fair value of long-term debt is based on year-end quoted market prices for similar debt of the same remaining maturities.

The carrying values of cash and temporary investments, accounts receivable, bank indebtedness and accounts payable and accrued charges approximate fair value because of the short maturity of these instruments.

Credit Risk

Financial assets expose Hydro One to credit risk. As at December 31, 1999, there were no significant concentrations of credit risk with respect to any class of financial assets. Cash and temporary investments include approximately $451 million of commercial paper. These investments are of short maturity with a high rating. Derivative financial instruments result in exposure to credit risk, since there is a risk of counter party default. As at December 31, 1999, Hydro One has not entered into any derivative financial instruments. With respect to the allocated debt, Ontario Hydro used various derivative financial instruments to hedge foreign exchange and interest rate risks. Ontario Hydro monitored and minimized credit risk related to derivative instruments by dealing only with diverse groups of highly rated counter parties and by entering into master agreements which incorporated netting provisions. Netting provisions enable the settlement of derivative financial assets and liabilities with the counter party on a net basis in the event that the counter party defaults.

Hydro One earns its revenue from a broad base of customers consistent with the draft revenue allocation agreement among the successor corporations. As a result, Hydro One does not earn a significant amount of revenue from any single customer. As at December 31, 1999, there were no significant balances of accounts receivable due from any single customer.

Note 13

Related Party Transactions

Prior to April 1, 1999, Hydro One, OPG, ESA and IMO were, in effect, business units of Ontario Hydro. Inter-business unit transactions are not available for 1998 due to the integrated nature of the operations of these entities. Upon the reorganization of Ontario Hydro, OPG, ESA and IMO became related parties of Hydro One because all of these entities are controlled by the Province.

Hydro One receives revenue for transmission services consistent with the draft revenue allocation agreement administered by OPG (see Note 2). Transmission revenue for 1999 includes $1,164 million related to these services. Revenues of $302 million were realized during the three months ended March 31, 1999, and $862 million was realized during the nine months ended December 31, 1999.

Hydro One receives revenue for distribution (including retail) services consistent with the draft revenue allocation agreement administered by OPG (see Note 2). Distribution (including retail) revenue for 1999 includes $106 million related to these services. Revenues of $27 million were realized during the three months ended March 31, 1999, and $79 million was realized during the nine months ended December 31, 1999.

Hydro One receives amounts for rural rate protection from customer revenue collected by the IMO (the Province prior to April 1, 1999) (see Note 2). Distribution (including retail) revenue includes $127 million related to this program, of which $7 million was paid to municipal electricity utilities in respect of annexation agreements. Net revenues of $31 million were realized during the three months ended March 31, 1999, and $89 million was realized during the nine months ended December 31, 1999.

Hydro One purchased power from OPG in the amount of $902 million in 1999. Hydro One purchased power from OPG in the amount of $264 million during the three months ended March 31, 1999, and $638 million during the nine months ended December 31, 1999.

Hydro One has several service level agreements with the successor corporations, primarily OPG. These services are provided or received on a cost recovery basis and include field and engineering, logistics, corporate, telecommunication and information technology services. The Company intends to negotiate future service level agreements on a commercial basis. Revenues include $64 million (transmission – $58 million; distribution – $6 million) related to the provision of services to the other successor corporations and operation, maintenance and administration costs include $47 million (transmission – $32 million; distribution – $15 million) related to the purchase of services from the other successor corporations. Revenues for the three months ended March 31, 1999, include $24 million and operation, maintenance and administration costs include $3 million related to these services. For the nine months ended December 31, 1999, revenues include $40 million and operation, maintenance and administration costs include $44 million related to these services.

All debt since the commencement of operations has been issued to OEFC. Financing charges include interest expense on this debt in the amount of $411 million. Allocated debt for the period prior to April 1, 1999, included bonds and notes payable to the Province as well as to unrelated parties. In respect of the allocated debt, Hydro One paid a provincial debt guarantee fee to the Province. Upon commencement of operations, the Province does not guarantee Hydro One's debt, and accordingly, the provincial debt guarantee fee is no longer incurred.

Provision for payments in lieu of corporate income taxes were paid or payable to OEFC and dividends were paid or payable to the Province (see Note 2).

The amounts due to and from related parties as a result of the transactions referred to above are as follows as at December 31, 1999:

December 31 (Canadian dollars in millions)	1999
Accounts receivable	144
Accounts payable and accrued charges	(169)
	(25)

Note 14

Consolidated Statements of Cash Flows

For the purposes of the consolidated statements of cash flows, cash and cash equivalents are defined as balance sheet item "Cash and temporary investments", net of balance sheet item "Bank indebtedness". Temporary investments are comprised of commercial paper with original maturities of less than 90 days. Cash and cash equivalents as at December 31, 1998, were notionally allocated to Hydro One based on its proportion of allocated Ontario Hydro debt.

The changes in non-cash balances related to operations consist of the following:

			1999	1998
		Acquired Businesses	Combined	Acquired Businesses
(Canadian dollars in millions)	9 months ended December 31	3 months ended March 31	Year ended December 31	Year ended December 31
Accounts receivable (increase) decrease	(37)	21	(16)	17
Materials and supplies (increase) decrease	(18)	2	(16)	(15)
Accounts payable and accrued charges increase (decrease)	66	5	71	(52)
Accrued interest increase (decrease)	72	6	78	(8)
Long-term accounts payable and accrued charges increase (decrease)	(65)	4	(61)	(2)
OPRB and OPEB liability increase	25	–	25	–
	43	38	81	(60)
Supplementary information:				
Interest paid	208	116	324	576
Payments in lieu of corporate income taxes	169	–	169	–

Note 15

Employee Benefit Plans

Employee benefit plans include the pension plan, the group life insurance plan, the group health care plan, the long-term disability plan and workers' compensation.

Pension Plan

This information has been derived from the OEFC Pension Plan and is based upon Hydro One's proportionate share of the plan assets and liabilities. Prior to April 1, 1999, such information was based upon Hydro One's proportionate share of Ontario Hydro's payroll.

During 1999, pension costs of $2 million (1998 – $4 million) were charged to results of operations and $1 million (1998 – $1 million) was capitalized as part of the cost of fixed assets. Of this, $0.5 million was charged to operation, maintenance and administration costs during the three months ended March 31, 1999, and $1.5 million was charged to operation, maintenance and administration costs during the nine months ended December 31, 1999. During the three months ended March 31, 1999, $0.3 million was capitalized and $0.7 million was capitalized during the nine months ended December 31, 1999.

In accordance with the transitional rate orders approved by the OEB, pension costs are recorded in results of operations when employer contributions are paid to the pension fund. On April 1, 1999, the deferred pension asset, representing the cumulative difference between employer contributions and pension costs, was increased to reflect Hydro One's actual number of employees and pensioners. Prior to April 1, 1999, the deferred pension asset was allocated based on Hydro One's proportionate share of Ontario Hydro's payroll. In addition, the Company recorded a regulatory liability in the amount of $241 million to reflect the fact that revenue and expenses are recognized in the financial statements in different periods, as directed by the regulator, than would be the case for an enterprise that is not rate-regulated (see Note 3).

The actuarial present value at December 31, 1999 of the accrued pension benefits, based on a projection of the valuation at December 31, 1998, and adjusted for $234 million additional liabilities associated with the voluntary retirement program, was estimated to be $3,690 million (1998 – $2,221 million). Pension plan assets available for these benefits were $4,296 million (1998 – $2,474 million).

The actuarial present value of the accrued pension benefits was determined using the following significant assumptions, which reflect management's best estimates:

I. Rate used to discount future pension benefits – 6.50% (1998 – 6.00%);

II. Salary escalation rate – 3.50% (1998 – 3.50%) plus an age and service dependent increase in respect of promotion, progression and merit;

III. Rate of improvement to future pension benefits for cost of living – 2.50% (1998 – 2.50%); and

IV. Average remaining service period of active employees – 11 years (1998 – 12 years).

The provisions of the *Electricity Act, 1998*, that relate to the OEFC Pension Plan allow Hydro One to reduce employer contributions to the pension fund to the extent permitted under the *Pension Benefits Act* when the plan has a surplus. In addition, contributions made by Ontario Hydro for the normal costs of the pension plan in respect of service after March 31, 1998, were refunded. As a result, the deferred pension asset was increased by $204 million to the value of the pension plan surplus, with a corresponding credit to 1998 results of operations.

Other Post-Retirement and Post-Employment Benefits

In addition to pension benefits, Hydro One provides OPRB such as group life insurance and health-care benefits and OPEB such as workers' compensation (WC) and long-term disability benefits (LTD).

As at April 1, 1999, a proportionate share of Ontario Hydro's OPRB and OPEB liabilities were assumed by Hydro One. Prior to April 1, 1999, these obligations were allocated to Hydro One based on the Company's proportionate share of Ontario Hydro's payroll.

During 1999, OPRB and OPEB costs of $30 million (1998 – $31 million) were charged to results of operations and $22 million (1998 – $7 million) were capitalized as part of the cost of fixed assets. Of this, $8 million was charged to operation, maintenance and administration costs during the three months ended March 31, 1999, and $22 million was charged to operation, maintenance and administration costs during the nine months ended December 31, 1999. During the three months ended March 31, 1999, $6 million was capitalized and $16 million was capitalized during the nine months ended December 31, 1999. Benefits paid were $29 million (1998 – $16 million). During the three months ended March 31, 1999, $7 million was paid and $22 million was paid during the nine months ended December 31, 1999. The OPRB and OPEB liabilities at December 31, 1999 were a combined $523 million (1998 – $351 million).

The OPRB and OPEB costs and liabilities were determined using the following significant assumptions, which reflect management's best estimates:

I. Rate used to discount future OPRB benefits – 6.00% (1998 – 6.00%);

II. Rate used to discount future LTD benefits – 5.50% (1998 – 5.50%);

III. Rate used to discount future WC benefits – 5.75% (1998 – 5.75%);

IV. Rate of improvement to future LTD benefits for cost of living – 2.50% (1998 – 2.50%);

V. Hospital and drug cost increase – 7.20% grading down to 4.50% after 3 years (1998 – 8.10% grading down to 4.50% after 4 years);

VI. Dental cost increase – 3.50% (1998 – 3.50%); and

VII. Average remaining service period of active employees – 11 years (1998 – 12 years).

On December 31, 1998, the rate used to discount future benefits was changed from a long-term average rate to a current market settlement rate and the increase in OPRB and OPEB liabilities of $108 million arising from this change was charged to shareholder's equity.

The accrued OPRB and OPEB obligation at December 31, 1999, based on a projection of the valuation at December 31, 1998, was $425 million (1998 – $351 million). This valuation used the same assumptions as those used to determine OPRB and OPEB costs and liabilities except the following, which reflect the current market settlement rate at December 31, 1999:

I. Rate used to discount future OPRB benefits – 7.50% (1998 – 6.00%);

II. Rate used to discount future LTD benefits – 7.00% (1998 – 5.50%); and

III. Rate used to discount future WC benefits – 7.25% (1998 – 5.75%).

In addition, the transitional rate orders issued by the OEB approved the amortization of obligations related to OPRB and OPEB in the amount of $419 million in Hydro One's revenue requirement on a straight-line basis over a 10-year period. The $419 million represents the transitional obligation associated with the change in accounting from a benefits paid basis to an accrual basis. The unamortized amount of this regulatory asset was $377 million at December 31, 1999.

Note 16

Contingencies

Legal Proceedings

As a result of Hydro One's acquisition of certain transmission, distribution and energy services assets, liabilities, rights and obligations of Ontario Hydro, Hydro One has succeeded Ontario Hydro as a party in a number of legal proceedings. In 1995, Torcom Communications Inc. (Torcom) named Ontario Hydro as one of several defendants in a suit seeking damages of $150 million, as well as specific performance of certain agreements and interim injunctive relief. Torcom had sought to purchase certain telecommunication devices belonging to a bankrupt company from the court-appointed receiver in bankruptcy. The devices had been installed on Ontario Hydro property under license to the original owner. Torcom claims that it reached an agreement with Ontario Hydro for the continued placement of the devices on Ontario Hydro property. Torcom alleges Ontario Hydro breached this contract and interfered with its efforts to purchase the devices from the receiver. There has been little activity on the case since 1995 when Ontario Hydro served a demand to particularize the allegations against it. Ontario Hydro did not receive a reply to its demand for particulars and has not yet served a statement of defense. Hydro One believes that there are strong defenses to the plaintiff's claims against Ontario Hydro and that it is unlikely that the outcome of the litigation will have a material adverse effect on its business, results of operations, financial position or prospects.

Hydro One is one of many defendants in a suit in the Ontario Court (General Division) commenced on October 18, 1995, asserting aboriginal title to certain land within the City of Sarnia. The plaintiff, The Chippewas of Sarnia Band, alleges that the land was not properly surrendered before a Crown Patent was issued in 1853 and therefore subsequent owners who took possession under the Crown Patent do not possess valid title. Hydro One

maintains transmission line facilities on portions of the disputed land. Hydro One cannot estimate the costs that might result from an adverse decision. On April 30, 1999, summary judgement was granted, dismissing the action against Ontario Hydro and certain of the defendants. On May 27, 1999, the plaintiff appealed the summary judgement order to the Court of Appeal for Ontario. Further, several defendants have also appealed the summary judgement order and others, including Hydro One, have filed cross-appeals. The appeals are currently scheduled to be heard on June 19, 2000. Hydro One believes that it is unlikely that the outcome of this litigation will have a material adverse effect on its business, results of operations, financial position or prospects.

On March 29, 1999, the Whitesand First Nation Band commenced an action in the Ontario Court (General Division), naming as defendants the Province, the Attorney General of Canada, Ontario Hydro, OEFC, OPG and the Company. A notice of intent to defend was filed on behalf of Hydro One. The action seeks declaratory relief, injunctive relief and damages in an unspecified amount. The Whitesand Band alleges that since at least the first half of the twentieth century, Ontario Hydro has erected dams, generating stations and other facilities within or affecting the band's traditional lands and that such facilities have caused damage to band members and the lands, including substantial flooding and erosion. The Whitesand Band also claims treaty rights to a share of the profits arising from the activities of these Ontario Hydro facilities, an entitlement to increases in annuity payments established by treaty and compensation for costs incurred in the course of prior negotiations of band grievances with Ontario Hydro. The Whitesand Band asserts multiple causes of action, including trespass, breach of fiduciary duty, nuisance and negligence. Hydro One believes that it is unlikely that the outcome of this litigation will have a material adverse effect on its business, results of operations, financial position or prospects.

Transfer of Assets

On April 1, 1999, in connection with the acquisition of its operations, Hydro One acquired and assumed assets, liabilities, rights and obligations of Ontario Hydro's electricity transmission, distribution and energy services businesses, except for certain transmission, distribution and other assets located on lands held for bands or bodies of Indians under the *Indian Act (Canada)*. Transfer of title to these assets did not occur because authorizations originally granted by the Canadian Federal Minister of Indian and Northern Affairs for the construction and operation of these assets could not be transferred without the consent of the Minister and the relevant Indian bands or bodies or, in several cases, because the authorizations had either expired or had never been properly issued. Hydro One manages these assets, which are currently owned by OEFC.

Hydro One has commenced negotiations with the relevant Indian bands and bodies to obtain the authorizations and consents necessary to complete the transfer of these transmission, distribution and other assets. Hydro One cannot predict the aggregate amount that it may have to pay to obtain the required authorizations and consents. Hydro One expects to pay more than $850,000 per year, which was the amount previously paid to these Indian bands and bodies by Ontario Hydro and which is the total amount of allowed costs in the transitional rate orders. If after taking all reasonable steps, Hydro One cannot otherwise obtain the authorizations and consents from the Indian bands and bodies, OEFC will continue to hold these assets for an indefinite period of time. Alternatively, Hydro One may have to relocate these assets from the Indian lands to other locations at a cost that could be substantial, or, in a limited number of cases, to abandon a line and replace it with diesel generation facilities. In such cases, Hydro One would apply to the OEB to recover these costs in future rate orders.

Environment

Hydro One is subject to extensive Canadian federal, provincial and local regulation with respect to environmental and other health and safety matters. Governmental authorities regulate current operating facilities and exercise continuing jurisdiction over facility modifications. Hydro One is subject to an administrative order issued against Ontario Hydro by the Ontario Ministry of the Environment on September 2, 1997. The order requires that power generating facilities where discharges are causing or may cause adverse effects, or where waste is stored without approval, be identified, assessed and, if necessary, remediated. This order

affects remote generating station sites and generating station switchyards operated by Hydro One. Hydro One's current estimates indicate that the total cost for assessment and remediation at the remote generating station sites will be approximately $19 million over a four- to six-year period. Hydro One's current estimate of its remediation and assessment costs associated with the generating station switchyards is approximately $3 million over a four- to six-year period.

Environmental regulations can change rapidly and may be difficult to predict. Because new or existing facilities may be subject to new standards imposed by environmental regulation, substantial expenditures may be required to comply with such regulations. Hydro One is currently reviewing the environmental condition of various properties and costs for investigation or remediation of such properties may exceed estimated amounts depending on the results of such review. Hydro One analyzes the costs of its obligations arising from environmental matters on an ongoing basis. The ultimate resolution of future environmental matters is not expected to have a material adverse effect upon the financial position or results of operations of Hydro One.

Year 2000

The year 2000 issue arises because many computer systems used two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. As a result of a comprehensive, three-stage program to identify and implement the changes necessary to achieve year 2000 readiness, Hydro One did not experience any significant disruption to business operations at the turn of the century or to date. Although the change in date has occurred, it is not possible to conclude that all aspects of the year 2000 issue that may affect the Company, including those related to customers, suppliers or other third parties, have been fully resolved.

Note 17

Commitments

The future minimum lease payments under operating leases for each of the five years subsequent to December 31, 1999, and in total thereafter are as follows:

Year ended December 31 (Canadian dollars in millions)	
2000	23
2001	23
2002	18
2003	14
2004	13
Thereafter	4
Total future minimum lease payments	95

Note 18

Subsequent Events

On March 31, 2000, the Company issued to the Province 12,920,000 5.5% cumulative preferred shares with a redemption value of $25.00 per share, and 99,990 common shares bringing the total number of outstanding common shares to 100,000. The Company is authorized to issue an unlimited number of preferred and common shares.

In consideration of the Company's issuance to the Province of preferred shares and common shares, the Province assumed the Company's obligations, including accrued interest from April 1, 1999, under the $3.76 billion promissory note effective as of March 31, 2000 and, in connection with the assumption of the Company's obligations by the Province, OEFC has released the Company effective as of March 31, 2000 from its obligations under the promissory note (see Note 3).

The preferred shares are entitled to an annual cumulative dividend of $18 million, which is payable on a quarterly basis. The preferred shares are redeemable at the option of the Province at a price of $25.00 per share plus any accrued and unpaid dividends if the Province sells a number of the Company's common shares which it owns to the public such that the Province's holdings are reduced to less than 50% of the Company's common shares. Hydro One may elect to pay all or part of this redemption price by issuing additional common shares to the Province. If the Province does not exercise its redemption right, the Company would have the ability to adjust the dividend on the preferred shares to produce a yield that is 0.50% less than the then current dividend market yields for similarly rated preferred shares. The preferred shares do not carry voting rights, except in limited circumstances, and would rank in priority to the common shares upon liquidation.

The common dividends are declared at the sole discretion of the Hydro One Board of Directors, and recommended by management based on results of operations, financial condition, cash requirements and other relevant factors such as industry practice and shareholder expectations. In accordance with resolutions made by the Board of Directors, in respect of the nine months ended December 31, 1999, $13.3 million in preferred dividends and $158 million in common dividends became payable to the Province, for a total of $171.3 million.

Note 19

Segment Reporting

Hydro One has three reportable segments:

I. The transmission business, which comprises the core business of providing transportation and connection services, as well as various services such as telecommunications and secondary land use, and is responsible for transmitting electricity throughout the Ontario electricity grid;

II. The distribution (including retail) business, which comprises the core business of delivering and selling electricity to customers, as well as energy services; and

III. An "other" segment primarily consisting of the results of Ontario Hydro International Inc.

The designation of segments has been based on a combination of regulatory status and the nature of the products and services provided. The accounting policies followed by the segments are the same as those described in the summary of significant accounting policies (see Note 2).

Segment information on the above basis is as follows:

9 months ended December 31, 1999 (Canadian dollars in millions)	Transmission	Distribution (including retail)	Other	Total
Revenues	932	1,298	45	2,275
Operation, maintenance and administration	339	310	20	669
Purchased power	–	638	24	662
Depreciation and amortization	137	128	2	267
Segment profit before financing charges	456	222	(1)	677

Acquired Businesses 3 months ended March 31, 1999 (Canadian dollars in millions)	Transmission	Distribution (including retail)	Other	Total
Revenues	305	518	27	850
Operation, maintenance and administration	93	90	11	194
Purchased power	–	264	13	277
Depreciation and amortization	42	31	2	75
Segment profit before transitional cost adjustment, provincial debt guarantee fee and financing charges	170	133	1	304

Combined Year ended December 31, 1999 (Canadian dollars in millions)	Transmission	Distribution (including retail)	Other	Total
Revenues	**1,237**	**1,816**	**72**	**3,125**
Operation, maintenance and administration	**432**	**400**	**31**	**863**
Purchased power	**–**	**902**	**37**	**939**
Depreciation and amortization	**179**	**159**	**4**	**342**
Segment profit before transitional cost adjustment, provincial debt guarantee fee and financing charges	**626**	**355**	**–**	**981**

Acquired Businesses Year ended December 31, 1998 (Canadian dollars in millions)	Transmission	Distribution (including retail)	Other	Total
Revenues	1,178	1,746	124	3,048
Operation, maintenance and administration	349	330	44	723
Purchased power	17	1,083	65	1,165
Depreciation and amortization	179	115	6	300
Segment profit before provincial debt guarantee fee, financing charges and deferred pension asset	633	218	9	860

December 31 (Canadian dollars in millions)	Transmission	Distribution (including retail)	Other	Total
Total assets				
1999	**6,658**	**3,431**	**1**	**10,090**
1998 (Acquired Businesses)	6,107	3,168	160	9,435

Year ended December 31 (Canadian dollars in millions)	Transmission	Distribution (including retail)	Other	Total
Capital expenditures				
1999 (Combined)	**327**	**196**	**6**	**529**
1998 (Acquired Businesses)	171	195	28	394

All revenues, costs and assets, as the case may be, are earned, incurred or held in Canada, except for the operations of Ontario Hydro International Inc. (see Note 7).

Note 20

Reconciliation to U.S. GAAP

The consolidated financial statements of Hydro One have been prepared in accordance with Canadian GAAP, which conforms in most respects to U.S. GAAP. Under both Canadian GAAP and U.S. GAAP, certain of the Company's accounting policies differ from those that would be followed by enterprises operating in a non-rate-regulated environment.

The material differences between Canadian GAAP, as used in the preparation of these consolidated financial statements, and U.S. GAAP are summarized below.

Consolidated Statements of Operations

Year ended December 31 (Canadian dollars in millions)	1999	1998
	Combined	Acquired Businesses
Net income	375	474
Adjustments increase (decrease):		
Pension costs (a)	–	(25)
Other post-retirement benefit costs (a)	–	(7)
Other post-employment benefit costs (a)	8	12
Staff reduction charges (b)	45	(6)
Environmental costs (c)	35	(3)
Corporate write-offs (d)	(24)	(2)
Net income and comprehensive income (U.S. GAAP)	439	437
Excess of assets over liabilities as at March 31, 1999	(2,686)	–
Excess of assets over liabilities, opening (U.S. GAAP)	2,565	2,128
Excess of assets over liabilities, closing (U.S. GAAP)	–	2,565
Retained earnings, closing (U.S. GAAP)	318	–

Consolidated Balance Sheets

December 31 (Canadian dollars in millions)	1999	1998
		Acquired Businesses
Assets: Increase (decrease)		
Fixed assets in service (a), (d)	16	23
Deferred pension asset (a)	150	3
Regulatory asset (e)	27	–
Liabilities: (Increase) decrease		
Accounts payable and accrued charges (b), (d)	46	(2)
Other post-retirement & post-employment benefits (a)	13	1
Long-term accounts payable and accrued charges (c)	(158)	(193)
Regulatory liability (a)	(150)	(3)
Deferred tax liability (e)	(27)	–
	(83)	(173)

(a) Pension and Other Post-Retirement and Post-Employment Benefits

At December 31, 1998, the Company's pension accounting conformed to U.S. GAAP. Effective April 1, 1999, in accordance with the transitional rate orders approved by the OEB, pension costs are recorded in results of operations when employer contributions are paid to the pension fund. As under U.S. GAAP, the deferred pension asset continues to be recorded. However, an offsetting regulatory liability has also been recorded. At December 31, 1999, the amount of the deferred pension asset, and corresponding regulatory liability, would have been $391 million under U.S. GAAP. Additional liabilities of $229 million under U.S. GAAP, associated with the voluntary retirement program would not be recognized as an adjustment to the deferred pension asset and corresponding regulatory liability until 2000. The amount of the deferred pension asset under U.S. GAAP of $391 million compares with the $241 million deferred pension asset and regulatory liability recorded on the Company's balance sheet at December 31, 1999.

Under Canadian GAAP, a long-term average rate of return is used to discount future pension benefits. Under U.S. GAAP, a current market settlement rate is used to discount future pension benefits. For pension cost purposes, the rate would have been 6.00% (1998 – 6.25%). The expected rate of return on pension plan assets is 7.25% (1998 – 9.00%). Past service costs and actuarial gains and losses are amortized over the

average remaining service period of active employees of 11 years (1998 – 12 years). The accrued pension benefit obligation as at December 31, 1999, based on a projection of the valuation at December 31, 1998, would have been based on the rate of 7.25% used to discount future pension benefits (1998 – 6.00%).

At December 31, 1998, following the adoption of new accounting recommendations issued by the Canadian Institute of Chartered Accountants, OPRB and OPEB liabilities conformed to U.S. GAAP.

Under U.S. GAAP, the OPEB liabilities at December 31, 1999, and 1999 OPEB cost would have been $13 million lower due to the immediate recognition of the actuarial gain due to a change in the current market settlement rate at December 31, 1999. Of this, $8 million would have been credited to results of operations and $5 million to the cost of fixed assets.

The 1998 pension, OPRB and OPEB costs differed from U.S. GAAP because of the timing of the adoption of the new accounting recommendations.

The following additional information regarding pension, OPRB and OPEB under U.S. GAAP is presented to conform to U.S. GAAP disclosure requirements.

Year ended December 31 (Canadian dollars in millions)	1999	1998 Acquired Businesses
Components of pension cost:		
Current service cost	67	50
Interest on accrued pension benefit obligation	214	129
Expected return on plan assets	(275)	(207)
Amortization of transition asset	–	(8)
Amortization of prior service cost	–	18
Amortization of net actuarial gains	(1)	(27)
Adjustment for pension plan surplus ownership	–	(130)
Pension cost	5	(175)
Pension plan assets:		
Fair value, beginning of year	2,474	2,324
Allocation adjustment	1,461	–
Employer contributions	–	7
Employee contributions	17	16
Actual return on assets	519	207
Benefits paid	(168)	(80)
Administration expense	(7)	–
Fair value, end of year	4,296	2,474
Accrued pension benefit obligation:		
Balance, beginning of year	2,246	2,070
Allocation adjustment	1,363	–
Current service cost	84	65
Interest on accrued pension benefit obligation	214	129
Benefits paid	(168)	(80)
Net actuarial losses (gains)	(624)	62
Balance, end of year	3,115	2,246
Pension plan surplus	1,181	228
Unamortized transition asset	–	(32)
Unamortized net actuarial gains	(790)	(104)
Unamortized prior service cost	–	135
Deferred pension asset	391	227

The following additional information regarding OPRB costs is presented to conform to financial reporting disclosure requirements in the United States:

Year ended December 31 (Canadian dollars in millions)	1999	1998 Acquired Businesses
Components of OPRB cost:		
Current service cost	9	6
Interest on accrued OPRB obligation	23	14
Amortization of net actuarial losses	2	2
Amortization of prior service costs	–	2
OPRB cost	34	24
Accrued OPRB obligation:		
Balance, beginning of year	241	193
Allocation adjustment	166	–
Current service cost	9	6
Interest on accrued OPRB obligation	23	14
Plan amendments	–	26
Net actuarial (gains) losses	(96)	9
Benefits paid	(16)	(7)
Balance, end of year	327	241
Unamortized net actuarial gains (losses)	85	(52)
Unamortized prior service cost	–	(23)
OPRB liabilities, end of year	412	166
OPEB liabilities, end of year	98	103

A 1% change in the assumed medical and dental cost would affect the accrued OPRB obligation and the current service cost and interest on the accrued OPRB obligation components of OPRB cost reported as follows:

(Canadian dollars in millions)	Accrued OPRB obligation	Current service cost and interest	Accrued OPRB obligation	Current service cost and interest
	1% increase		1% decrease	
1999	**35**	**4**	**(29)**	**(3)**
1998	37	3	(29)	(3)

(b) Staff Reduction Charges

Under Canadian GAAP, costs relating to staff reduction programs are recognized at the time management approves such reductions and the costs can be reasonably estimated. Under U.S. GAAP, the cost of staff reduction programs may not be recognized unless the program specifically identifies the number of employees and their job classification and location, and the terminations will occur within one year from the date that management approves the reduction program. Ontario Hydro recognized staff reduction costs of $18 million in 1997. An additional $3 million was allocated to Hydro One on April 1, 1999. Actual staff reduction expenditures of $1 million were incurred in 1999 (1998 – $6 million). The remaining $14 million provision was reversed to results of operations in 1999 (see Note 4).

Hydro One has also recognized in 1999 a new provision for voluntary staff reduction costs expected to be incurred in 2000. Under Canadian GAAP, such costs can be recognized when a reasonable estimate of the cost of offering a voluntary retirement program can be made. Under U.S. GAAP, such costs can only be recognized when employees actually accept an offer of early retirement. Under U.S. GAAP, the new provision of $60 million would not have been recognized as a 1999 charge to results of operations.

Under U.S. GAAP, that portion of the staff reduction program to be funded with surplus pension assets would be recorded as equal reductions of the deferred pension asset and the corresponding regulatory liability when appropriate recognition criteria have been met. As a result, the results of operations and shareholder's equity would not be affected under U.S. GAAP.

(c) Environmental Costs

Ontario Hydro's policy for environmental costs was to recognize expenditures to settle past environmental damage as incurred. Hydro One continues to apply this policy. Under U.S. GAAP, future costs are to be recognized when it is likely that a liability has been incurred and when the amount and timing of the future costs are reasonably estimable. Under U.S. GAAP, a charge for estimated future costs associated with the removal and destruction of PCBs and for land assessment and remediation in the amount of $184 million would have been recorded in 1997. This amount would have been increased by $28 million in 1998 as a result of improved cost estimates and additional assessments carried out during 1998.

In 1998, environmental expenditures totalling $19 million were charged to results of operations. Under U.S. GAAP, these expenditures would have been charged to the balance sheet provisions established in 1997 and 1998. As such, the net adjustment for 1998 for U.S. GAAP purposes, taking into account the additional $28 million liability to be recognized under U.S. GAAP referred to above and the $19 million that would have been charged to the existing environmental liability provision, is $9 million.

In 1999, Hydro One reviewed its estimates of future environmental costs and determined that the 1997 and 1998 amounts that were identified as warranting a provision under U.S. GAAP had not changed. Hydro One incurred actual environmental costs of $35 million in 1999. Had these amounts been accounted for under U.S. GAAP, they would have been charged to the balance sheet provisions established in 1997 and 1998 rather than as a charge to 1999 results of operations.

(d) Corporate Write-offs

A $33 million write-off related to a decision to dispose of certain field operation centres and included in 1997 operations, maintenance and administration would not have been recognized in that year under U.S. GAAP. The $33 million amount represented $25 million for a write-down of specific fixed assets and $8 million for a provision for non-discretionary post-occupancy costs. Under U.S. GAAP, the fixed assets would have remained on Hydro One's balance sheet as assets held for future use and depreciation of $2 million per year would have continued. The post-occupancy costs of $8 million have been removed from accounts payable and accrued charges and the opening U.S. GAAP balance of the excess of assets over liabilities.

In 1999, under Canadian GAAP, Hydro One reversed a $22 million provision to results of operations. This provision was originally recognized in 1993 for post-occupancy costs related to certain surplus real estate properties. The provision would not have been recognized under U.S. GAAP in 1993 and, as a result, has been removed from the opening excess of assets over liabilities in 1997 under U.S. GAAP. In the U.S. GAAP reconciliation, the provision has been removed from accounts payable for 1998 and 1999 and the effect of the reversal has been removed from the Statement of Operations for 1999.

(e) Deferred Income Taxes

U.S. GAAP requires the reporting and display of deferred income tax liabilities and assets on the balance sheet. To the extent that the deferred income taxes are expected to be included in the approved rates charged to customers in the future, the Company would record a regulatory asset. The amount of deferred taxes reported for U.S. GAAP purposes is based on information included in Note 9.

(f) Proportionate Consolidation of Joint Ventures

Under Canadian GAAP, Hydro One accounted for its indirect investment in Ontario Quinta using the proportionate consolidation method (see Note 7). Under U.S. GAAP, Hydro One's indirect investment in Ontario Quinta would have been accounted for using the equity method. However, U.S. securities regulations allow Hydro One to omit from the U.S. GAAP reconciliation the differences resulting from the use of the proportionate consolidation method, subject to the provision of the information included in Note 7.

(g) Transitional Cost Adjustment

As set forth in Note 6 to the financial statements, the Company recorded a transitional cost adjustment in the first three months of 1999. Under U.S. GAAP, the transitional cost adjustment would not be recognized in the specific cost line items in the first three months of 1999. Instead, under U.S. GAAP, the transitional cost adjustment would have been netted against revenue.

(h) Future Accounting Pronouncements

The U.S. Financial Accounting Standards Board has issued new standards on accounting for derivative financial instruments and hedging activities under Statement No. 133, effective for fiscal years beginning on or after June 15, 2000. Statement No. 133 establishes accounting and reporting standards requiring that all derivative instruments (including certain derivative instruments embedded in other contracts) be recorded in the balance sheet as either assets or liabilities measured at their fair value. In addition, Statement No. 133 requires that changes in a derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. If these criteria are met, and the Company has formally documented, designated and assessed the effectiveness of qualifying transactions, gains and losses on the derivatives may be offset against losses and gains on the hedged item in the income statement. Hydro One has not yet determined the extent to which it will use derivatives in the future and, therefore, the related effect of the new standards on its financial statements.

Year ended December 31 (Canadian dollars in millions)	1999	1998	1997	1996
	Combined	Acquired Businesses	Acquired Businesses	Acquired Businesses
Statement of operations data				
Revenues	**3,125**	3,048	3,099	3,129
Costs				
Operation, maintenance and administration[2]	**863**	723	706	602
Purchased power	**939**	1,165	1,250	1,218
Depreciation and amortization	**342**	300	302	305
Transitional cost adjustment[3]	**55**	–	–	–
Provincial debt guarantee fee[4]	**8**	31	32	31
Deferred pension asset	**–**	(204)	–	–
	2,207	2,015	2,290	2,156
Other income				
Gain on sale of investment[5]	**32**	–	–	–
Income before financing charges and provision for payments in lieu of corporate income taxes	**950**	1,033	809	973
Financing charges	**381**	559	584	590
Income before provision for payments in lieu of corporate income taxes	**569**	474	225	383
Provision for payments in lieu of corporate income taxes[6]	**194**	–	–	–
Net income	**375**	474	225	383

1 Ontario Hydro began maintaining internal accounting records on a separate business unit basis in late 1998. Consequently, only four years of historical data is available. The historical results of operations and financial positions may have been different if Hydro One had been a stand-alone corporation with its own management and capital structure, rather than a business unit of Ontario Hydro.

2 Operation, maintenance and administration for 1999 includes charges for a staff reduction program, net of the reversal of certain provisions. In 1997, Ontario Hydro's Board of Directors approved write-offs related to its field operation centres and certain pilot programs. In addition, a provision for the consolidation of facilities and planned employee reductions was recorded (see Note 4).

3 The transitional cost adjustment is a one-time charge related to the first three months of 1999 (see Note 6).

4 The provincial debt guarantee fee was an annual fee equal to one-half of one percent (0.5%) on the total debt guaranteed by the Province outstanding as of the preceding December 31. This fee was eliminated effective April 1, 1999 (see Note 13).

5 The gain on sale of investment relates to the sale of the Company's 25% equity interest in Ontario Quinte (see Note 7).

6 As of April 1, 1999, Hydro One is required to make payments in lieu of corporate taxes (see Notes 2 and 9).

Year ended December 31 (Canadian dollars in millions)	1999	1998	1997	1996
	Combined	Acquired Businesses	Acquired Businesses	Acquired Businesses
Financial position data				
Total assets	**10,090**	9,435	9,059	9,002
Other financial data				
EBITDA[7]	**1,292**	1,333	1,111	1,278
Capital expenditures				
Transmission	**327**	171	176	161
Distribution	**196**	195	126	147
Other	**6**	28	22	6
Ratios				
Net asset coverage on long-term debt[8]	**1.83**	1.43	1.37	1.33
Interest coverage[9]	**2.26**	1.82	1.37	1.63
U.S. GAAP (Canadian dollars)				
Net income and comprehensive income	**439**	437	88	379
Excess of assets over liabilities	**–**	2,565	2,128	2,040
Shareholder's equity	**4,077**	–	–	–
Interest coverage[9]	**2.42**	1.75	1.13	1.62
Operating statistics				
Transmission:				
Units transmitted (TWh)	**144.1**	143.0	144.8	143.0
System peak demand (MW)	**23,435**	22,443	22,197	22,321
Total transmission lines (kilometres)	**28,889**	29,069	29,080	29,080
Distribution:				
Units distributed (TWh)	**18.1**	18.3	18.8	18.6
Total distribution lines (kilometres)	**113,400**	116,947	119,182	118,985
Customers[10]	**933,990**	977,835	973,439	962,943
Total employees[11]	**5,632**	5,221	5,222	5,478

[7] **EBITDA represents income before financing charges, provision for payments in lieu of corporate income taxes, depreciation and amortization and does not include financing income.**

[8] **Net asset coverage on long-term debt is calculated as total assets minus total liabilities excluding long-term debt, including current portion, divided by long-term debt, including current portion. Net asset coverage on long-term debt would have been 1.80 had the common and preferred dividends been paid in 1999.**

[9] **Interest coverage is calculated as income before interest expense and provision for payments in lieu of corporate income taxes divided by total interest cost. In 1999, the gain on the sale of the investment in Ontario Quinte is excluded from income for the purpose of calculating interest coverage.**

[10] **As of April 1, 1999, Hydro One served approximately 934,000 retail customers. The reduction over prior years is a result of recently completed statutory annexations of a small portion of facilities by several municipal electricity utilities (see Note 10).**

[11] **Total employees for 1999 reflect Hydro One as a stand-alone company rather than as a business unit of Ontario Hydro.**

The Board of Directors, constituted in December 1998, has 12 members, eight men and four women. The President and Chief Executive Officer is the only member of the management team who is also a Director.

In its first year, the Board held 14 meetings. Board Committees met a total of 27 times and three workshops took place. There was an overall attendance by Board members of 94 percent.

The Board of Directors has approved a Code of Business Conduct and a Guide for Directors has been published. The Corporate Governance Committee has initiated an annual review of Board effectiveness, the first of which has been completed.

Sir Graham Day[4]
Chairman of the Board
Hydro One Inc.
Hantsport, Nova Scotia

Eleanor R. Clitheroe[1,2,3,4]
President and
Chief Executive Officer
Hydro One Inc.
Toronto, Ontario

Robert E. Gillespie
Chairman and
Chief Executive Officer
General Electric Canada
Incorporated
Mississauga, Ontario

Allister P. Graham[3]
Corporate Director
Toronto, Ontario

Dona Harvey[1,3]
Management Consultant
Kitchener, Ontario

Stephanie Kushner
Vice President and Treasurer
FMC Corporation
Chicago, Illinois

Radcliffe Latimer[1,3]
Corporate Director
Toronto, Ontario

Doug McCaig[1,3]
Corporate Director
Fort Frances, Ontario

Gedas A. Sakus[4]
Corporate Director
Toronto, Ontario

Martin Bernard Syron[3]
Chairman
Cara Operations Limited
Toronto, Ontario

Roslyn Watson[1,3]
President
Watson Ventures
Boston, Massachusetts

John F. Wilson[1,3]
Engineer, President of the
Society of Energy Professionals
Toronto, Ontario

[1] Indicates Director serves on the Board of Hydro One Networks

[2] Indicates Director serves on the Board of Hydro One Remote Communities

[3] Indicates Director serves on the Board of Ontario Hydro Energy

[4] Indicates Director serves on the Board of Hydro One Telecom

Each committee proposed a draft mandate to the Corporate Governance Committee which is responsible for recommending committee mandates to the Board for approval. Each of the Board Committees has adopted an Annual Work Plan and in each case a company officer has been appointed as the primary management liaison with the respective Committee Chairs in order to help progress committee work.

Audit and Finance Committee

The Audit and Finance Committee is responsible for reviewing and making recommendations to the Board of Directors regarding the financing plans and objectives of the company. The Audit and Finance Committee reviews the audited annual Consolidated Financial Statements and related management discussion and analysis disclosures as well as all financial statements issued in connection with any offerings of our securities as required by regulatory authorities. The committee met six times in 1999.

Members:

Robert E. Gillespie, Chair
Eleanor R. Clitheroe
Sir Graham Day
Allister P. Graham
Stephanie Kushner
Radcliffe Latimer
Martin Bernard Syron

Corporate Governance Committee

The Corporate Governance Committee is responsible for the Board's governance of the Company. It recommends issues to be discussed at Board meetings, annually reviews the mandates of each committee of the Board of Directors, monitors the quality of management's relationship with the Board of Directors and recommends suitable nominees for election to the Board of Directors. The committee met seven times in 1999.

Members:

Allister P. Graham, Chair
Eleanor R. Clitheroe
Sir Graham Day
Robert E. Gillespie
Dona Harvey

Human Resources and Public Policy Committee

The Human Resources and Public Policy Committee is responsible for reviewing the status of the Code of Business Conduct, the appropriateness of our current and future organizational structure, succession plans for corporate and divisional officers, review of the performance and remuneration of our senior executives, including recommending to the Board the remuneration of the President and Chief Executive Officer, and the identification, assessment and provision of advice to the Board of Directors on public affairs issues that have significant impact on us. The committee met six times in 1999.

Members:

Dona Harvey, Chair
Eleanor R. Clitheroe
Sir Graham Day
Doug McCaig
Gedas A. Sakus
Martin Bernard Syron

Regulatory, Health, Safety and Environment Committee

Throughout 1999, the Regulatory, Health, Safety and Environment Committee of Hydro One was responsible for ensuring compliance with all applicable occupational health, safety and environmental legislation as well as any applicable regulatory requirements. The committee establishes compliance programs, policies, standards and procedures, formulates contingency plans and reviews compliance actions and reports. This committee met eight times in 1999.

In February 2000, the Regulatory, Health, Safety and Environment Committee was established as a committee of the Board of Hydro One Networks. As the utility, Hydro One Networks is fully regulated under the Ontario Energy Board. It was determined therefore that the regulatory component of the committee should be at the subsidiary level rather than the holding company level. Moreover, since Hydro One Networks accounts for 95 percent of all employees and the vast range of environment, health and safety issues facing the company relate to the daily operations in the wires business, this move provided an opportunity for the Networks Board to focus attention on these issues. The mandate of the committee is the same under the Hydro One Networks Board.

Members:

Radcliffe Latimer, Chair
Eleanor R. Clitheroe
Sir Graham Day
Dona Harvey
Doug McCaig
Gedas A. Sakus
Roslyn Watson
John F. Wilson

Chairman of the Board and Senior Officers of Hydro One

Hydro One Inc.

Sir Graham Day
Chairman of the Board

Eleanor Clitheroe
President and
Chief Executive Officer

Malen Ng
Executive Vice President and
Chief Financial Officer

Joan Prior
Executive Vice President
General Counsel and Secretary

Rod Taylor
Executive Vice President
Planning and Development

Senior Officers of Operating Subsidiaries

Hydro One Networks Inc.

Eleanor Clitheroe
Chair

Courtney Pratt
President and
Chief Executive Officer

Hydro One Remote Communities Inc.

Eleanor Clitheroe
Chair

Ron Stewart
President and
Chief Executive Officer

Hydro One Telecom Inc.

Eleanor Clitheroe
Chair

Joan Prior
President and
Chief Executive Officer

Hydro One Markets Inc.

Eleanor Clitheroe
Chair

Malen Ng
President and
Chief Executive Officer

Ontario Hydro Energy Inc.

Eleanor Clitheroe
Chair

Mike Miller
President and
Chief Executive Officer

As a new company establishing itself in every way, during 1999 we were focused on establishing a wide range of programs and policies that would help us meet our goals of becoming a leading North American energy services company. We wanted to maintain and build on the trust and confidence of our employees, customers, stakeholders, business associates and communities in which we operate. To earn that trust and confidence, we committed to conducting ourselves according to our Code of Business Conduct. Integrity, excellence and citizenship are the best beacons for guiding us toward sound business decisions and determining the right answers to difficult issues.

In keeping with our Code of Business Conduct, we are committed to supporting the communities where we work, live and serve. In keeping with that commitment, we developed a new corporate donations strategy during 1999. We began by conducting extensive research and benchmarking against leading Canadian and American companies. We consulted with our Board of Directors, employees, customers and the public. The result is a new Hydro One charitable giving program that will strengthen and re-establish a grassroots presence in our communities. The focus of our program is on safety-related causes in worthwhile community-based projects in Ontario.

Our program ranges from cash donations, volunteering, gifts-in-kind and other community relations initiatives.

Our broad-based safety theme builds on an important strategic area for us, while also being an area where our customers told us we could offer practical and trusted guidance to communities. The program, still in its infancy, will support programs that focus on making our communities safer places. We will support a wide range of initiatives, depending on the needs of the community.

The safety theme allows us to partner on community projects with other essential service providers such as provincial police, fire and ambulance services.

An employee volunteerism component supports the strong spirit of community and charity involvement among our employees. Our program will build on this commitment through a focused program across the province.

Our program also directs a portion of its funds to programs for First Nations' communities in Ontario.

Moving forward, our goal is to establish a level of funding that both is sustainable over time and has a meaningful impact on our communities. During 2000, we will be working with our communities to develop and launch the program.

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This annual report is also available in a downloadable format on our web site at www.HydroOne.com.

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Ernst & Young LLP

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Bernard Bohn (Directors and Management)
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hydro one

hydro One

OntarioHydro energy

Throughout the year 2000, we will be launching our new identity and new businesses under a name that goes to the heart of the essential service we provide and the lifelines we maintain across our many communities. Hydro One takes the word often associated with "electricity" in Canada and marries it with our aspiration to be "best in class" in the energy delivery business in North America. The "One" in the Hydro One name is a reference to our orientation to put our customers first in everything we do.

From April 1, 1999, until April 30, 2000, we operated under our transitional identity, Ontario Hydro Services Company. Through a focused branding exercise designed to help shape the values and attributes of the new company, we identified the need to develop a new name and meaningful graphic symbols. We sought public, employee, customer and government input as an important part of this process.

We developed two graphic symbols to meet our specific goals. For our operating businesses, which represent our public face, we built on the strength of the Ontario Hydro plug logo by modernizing a version to illustrate a more dynamic and approachable company. Our slogan – Connecting at the speed of life™ – captures our essence and inspires top performance.

For our holding company, we adopted a stylized swirl, or letter "O", representing a cable or wire moving from the past to the future. This illustrates our focus as an infrastructure company that is continuously improving. As we go through the period of restructuring of Ontario's power sector, we want to ensure that we are recognized for our long-standing history in this industry. That's why our competitive retail company, Ontario Hydro Energy, will maintain the original identity for a transitional period and will migrate to the new identity over time.

Our new name signals a break from the past, while honouring the legacy of over 90 years of service to the people of Ontario. With the launch of Hydro One, we are moving ahead on our own merits. It's a powerful new name built on strength and full of energy and promise. Just like the company itself.